SELECTED READINGS IN PUBLIC FINANCE

BULLOCK

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SELECTIONS AND DOCUMENTS IN ECONOMICS

EDITED BY

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SELECTED READINGS IN PUBLIC FINANCE

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PREFACE

THIS volume aims to bring together under one cover the collateral reading needed for a general course in public finance. It is intended to supplement the instruction usually given by lectures and text-books. The selections have been drawn from a considerable variety of sources, both new and old, and deal with most of the topics ordinarily included in such a course. Upon various controverted questions the arguments of the earlier disputants have been reproduced, and in other cases an effort has been made to draw upon the work of the older standard authors. In this way it is hoped that the book will serve a useful purpose in introducing the student to the literature of the science of finance.

It would be a pleasure to make express acknowledgment here of the many favors which have been granted in the preparation of the volume. But the footnotes to the various selections serve this general purpose; and the editor must be content simply to record his appreciation of the cordial coöperation of the authors who have given him permission to draw upon their works, and of the publishers who have consented to the reproduction of copyrighted material. Thanks are due also to the editor's wife, upon whom fell a large share of the harder work attending the preparation of the book.

CHARLES J. BULLOCK.

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SELECTED READINGS IN PUBLIC FINANCE

CHAPTER I

THE LITERATURE OF PUBLIC FINANCE[1]

1. Mediæval Finance. — Some of the subjects treated by public finance have never escaped entirely the attention of historians[2] and writers upon statecraft or political philosophy.[3] Until the close of the Middle Ages, however, the financial transactions of European states were not sufficiently important to invite anything approaching systematic study. Kings were supported chiefly by the revenues derived from their private domains or various fiscal prerogatives, while taxation was in theory — and generally in practice — an extraordinary resource, reserved, as Thomas Aquinas held it should be, for unusual emergencies.[4] The finances of a feudal state were hardly more than the finances of a royal household; and, in fact, savored rather of private than public housekeeping.[5] In the eleventh and twelfth centuries, with the revival of industry and commerce, numerous

[1] For an extended bibliography see Stammhammer, Bibliographie der Finanzwissenschaft (1903).

[2] A work enititled The Revenues of Athens, commonly attributed to Xenophon, discusses methods of improving the wealth and revenues of that city. Roman historians occasionally mentioned the subject of taxation; Tacitus and Suetonius are examples.

[3] In the thirteenth and fourteenth centuries some of the Schoolmen touched upon certain financial questions. Thomas Aquinas, for instance, considered the rights of the sovereign in respect to taxation. In ordinary times, he taught, the King should live upon the income from his domains; but in time of extraordinary emergencies, his subjects should submit to taxation, which, however, ought to be moderate and just. Similar maxims were expressed by Petrarch (De republica optime administranda), and by other Humanists.

[4] Aquinas wrote: "*Unde constituti sunt reditus terrarum Principibus, ut ex illis viventes a spoliatione subditorum abstineant.*"

[5] One of the laws of Charlemagne, the capitulary *de villis*, lays down the following rules for the management of the Emperor's estates: "We desire that each steward

towns began to grow rapidly in various parts of Europe and to gain a large measure of independence in internal affairs. With them, problems of finance soon engaged attention, and financial institutions early assumed something like a modern character. Poll and property taxes were introduced, duties laid upon articles of consumption, and municipal debts created. Yet, so far as we know, these interesting developments did not, outside of Italy, call forth any noteworthy discussion of financial problems.

2. The Formative Period. — In Italy, however, the quickening of intellectual life and the growing importance of commercial and financial transactions led to interesting developments in the fifteenth century. At Florence various financial problems came to the forefront, and the question of progressive taxation aroused the keenest interest.[1] In the Kingdom of Naples, moreover, Diomede Carafa, a soldier and statesman, produced a most interesting treatise upon statecraft (De regis et boni principis officio), in which financial questions received more serious treatment than ever before, perhaps, had been accorded to them. Carafa devoted one of the four parts of his work to the administration of the revenues of the prince. In general, he stood upon the ground of his predecessors, such as Aquinas and Petrarch, holding that income from domains should be the basis of state finance, and taxes a subordinate form of revenue. But he pro-

shall make an annual statement of all our income, giving an account of our lands cultivated by the oxen which our own plowmen drive and of our lands which the tenants of farms ought to plow; of the pigs, of the rents, of the obligations and fines; of the game taken in our forests without our permission; of the various compositions; of the mills, of the forest, of the fields, of the bridges and ships; of the free men and the distr[illegible] of obligations to our treasury; of markets, vineyards, and those who owe wine to us; of the hay, firewood, torches, planks, and other kinds of lumber; of the waste lands; of the vegetables, millet, panic; of the wool, flax, and hemp; of the fruits of the trees; of the nut trees, larger and smaller; of the grafted trees of all kinds; of the gardens; of the turnips; of the fish ponds; of the hides, skins, and horns; of the honey and wax; of the fat, tallow, and soap; of the mulberry wine, cooked wine, mead, vinegar, beer, and wine, new and old; of the new grain and the old; of the hens and eggs; of the geese; of the number of fishermen, workers in metal, sword makers, and shoemakers; of the bins and boxes; of the turners and soldiers; of the forges and mines, — that is, of iron, lead, or other substances; of the colts and fillies."

[1] Palmieri (1405–1475) and Guicciardini (1483–1540) are the most important writers to be mentioned in this connection. For an account, in English, of progressive taxation in Florence, see Seligman, Progressive Taxation, 22–26, 70.

ceeded to divide public expenditures into three classes: (1) those for the defense of the state; (2) those for the support of the prince; and (3) those for contingencies. Expenses, he said, should be moderate, so that a balance may remain which will be available for emergencies; then, too, economy makes it possible to dispense with bad taxes and to use only the best. Taxes, he argued, should be stable, and should be certain, so that citizens may know precisely what they are expected to pay. All revenues, finally, should be strictly accounted for, and the accounts should be frequently examined by the proper officers. In all things the prince should remember that the wealth of his subjects is the real foundation of a prosperous condition of his finances.[1]

By the close of the sixteenth century the growth of vigorous monarchies upon the ruins of the feudal system had proceeded far enough to compel more serious consideration of politics and finance.[2] In 1576 Jean Bodin published a celebrated work upon political philosophy (Les six livres de la republique), which for many years exercised a wide influence upon writers in all the countries of Europe. Bodin devoted the sixth book of his treatise to "several political questions," one of which was the proper management of the finances, "the nerves of the state." For such management, he said, three things are necessary: "The first is honest means of raising revenues; the second is to employ them for the profit and honor of the state; and the third, to save some portion of them for time of need." Concerning the first point, he argued that domains are "the most honest and assured" form of revenue; but he approved of customs duties "upon merchants who bring in or take out commodities, which are one of the oldest, most common, and most equitable" of financial devices; and admitted the propriety of direct taxes[3]

[1] Carafa said: "*Subditorum quippe facultates potentiae regiae fundamentum existimari opporteret.*"

[2] Financial problems became important on account of the growth of public expenses, the increasing frequency and weight of taxes, and the many evil expedients, such as forced loans or debasements of the currency, employed in order to raise money.

[3] Bodin contended, however, that in Spain, England, Germany, and France it was established, by long custom, that "no prince has power to levy a tax upon his subjects, or to require this duty, without their consent."

upon the subjects of the prince when "all other means are insufficient and there is urgent necessity of providing for the state." Under the second topic, the employment of the revenues, Bodin mentions the various branches of outlay,[1] condemns extravagance, urges the need for economy, and advises that an annual account be prepared, showing the condition of the finances. And, finally, upon the third topic, Bodin urged that out of the revenues a reserve, or treasure, should be accumulated in order that the state "may not be obliged to begin a war by borrowing or levying a subsidy." Borrowing at interest he believed to be the ruin of princes and their finances.

During the seventeenth and eighteenth centuries public finance was increasingly studied in Germany, where not a few professors in the universities and officials in the service of various German states were occupied with the subject. Regarding finance as an important branch of public business, they generally approached it from the point of view of the prudent administrator, anxious to husband and develop the resources of his estate.[2] While, at the start, many of them were greatly influenced by Bodin, they investigated assiduously the conditions existing in the German states, and in time gave their studies an independent basis. In the writings of J. H. von Justi[3] German financial science of the eighteenth century reached its ripest development. Justi divided finance, as Bodin had done, into three parts: the study of revenues, of expenditures, and of methods of meeting extraordinary emergencies. Like other cameralists, he considered the income from domains the real foundation of public housekeeping, and taxes a subordinate

[1] He gives the following *résumé*: "With the King's household maintained, the troops and their officers paid, and just wages given to those who have earned them, it is right that the poor should be remembered. And if any funds remain, they should be employed in rebuilding towns, fortifying strongholds, building forts on the frontier, improving the roads, repairing bridges, equipping ships, constructing public edifices, and establishing colleges of honor, virtue, and learning."

[2] Finance became, in this way, a part of what was known as "cameral science," which included all branches of knowledge needed for the proper administration of the possessions of the prince. Sometimes "cameral science" was used in a narrower sense, as equivalent to financial science, and thus was contrasted with the cameralistic sciences in the broader sense.

[3] Staatswirthschaft, oder systematische Abhandlung aller oekonom. und Kameralwissenschaften (1755).

form of revenue. Yet this did not prevent him from studying the various kinds of taxes, in their economic and political bearings, more carefully than most other writers had done. Public expenditures he treats in some detail, assigning to military outlay at least one half of the total. In order to finance serious emergencies he favored, like nearly all his forbears, the accumulation of a state treasure; yet he considers also the other expedient, public debts.

Although Bodin's work was translated into English (1606), financial topics received less attention in England than in Germany during the greater part of the seventeenth century. Sir William Petty's Treatise of Taxes and Contributions (1662) was probably the first English work which professed to deal primarily [1] with public finance. In this, with numerous digressions, the author treats of public expenditures and revenues. The former he divides into: (1) outlay for "Defence by Land and Sea"; (2) outlay for the "Maintenance of the Governours, Chief and Subordinate"; (3) outlay for the support of religion; (4) outlay for education; (5) outlay for the relief of orphans, the impotent, and the destitute; and (6) outlay for various public works, such as highways and bridges. Petty then considers the various branches of revenue, holding that a tax upon the land of a kingdom is better than the reservation of "Crown Lands." He favored excise taxes, also, believing that they tended to distribute burdens in a fair manner, *viz.* in proportion to what every man "taketh to himself, and actually enjoyeth"; and discussed the advantages and disadvantages of other forms of taxation. After 1690 the growth of national expenditures and taxes, together with the rapid increase of the national debt, stimulated the discussion of such subjects as taxation and public debts; so that a large number of tracts and treatises, often of a fugitive character, made their appearance. Methods of dealing with the debt were warmly debated, and the best methods of raising the large revenues now required by the government formed another engrossing topic. Some writers advocated a general excise upon articles of consumption, and others

[1] Other works had dealt incidentally and briefly with financial topics. Thomas Mun's England's Treasure by Forraign Trade (written prior to 1641 and published 1664) devotes three short chapters to public revenues and treasures.

wished to confine such taxation to luxuries; some preferred a single tax upon land or a tax upon houses, while others argued for a general property tax or a combination of different kinds of taxes. Out of such discussions of particular topics a large body of financial literature had developed in England by the middle of the eighteenth century.[1] Yet little of the writing had been systematic, and nothing like a comprehensive treatise upon finance had come into existence.

In France, after the time of Bodin, comparatively little attention was given to the study of finance until disorders and abuses in the public housekeeping had become so grave as to call loudly for reform. Early in the eighteenth century Marshal Vauban, who in the course of his campaigns had observed the wretched condition of many parts of the country, proposed reforms in taxation, by which a tax upon all incomes, supplemented by various duties upon imports and articles of consumption, should replace existing taxes. In 1748 appeared Montesquieu's celebrated Ésprit des lois, which treats of both taxation and public debts, briefly, but in a manner which influenced not a little the subsequent course of thought. Montesquieu emphasized particularly the political relations of public finance, observing, for instance, that a free people will submit to heavier taxation than a despotic ruler can impose upon his subjects; and took a very unfavorable view of public debts. Ten years later Quesnay, the founder of the Physiocratic School, published his Tableau oeconomique, in which he developed the first consistent theory of the production and distribution of wealth, and correlated the theory of taxation with the fundamental doctrines of his new science. Holding that the net produce of the land is the only source from which the wealth of a society can be increased and the only fund from which taxes can be drawn, the Physiocrats argued that all other taxes should be abandoned and public revenue raised by a single tax upon the "*produit net*" of the soil.[2] Beyond urging that govern-

[1] Of this copious literature David Hume's essays on "Taxes" and "Public Credit" (1752) may be mentioned; also Sir James Steuart's Inquiry into the Principles of Political Economy (1767), which, besides considering the subject of public credit, devotes an entire book to taxes.

[2] Quesnay, in the Tableau oeconomique, showed that it followed from his theory of

ments should confine their activity to the narrowest possible limits, and, therefore, exercise economy in their expenditures, the Physiocrats contributed nothing further to the history of public finance.

A new era opened with the publication of Adam Smith's Wealth of Nations (1776). Drawing upon the work of his predecessors and the results of his own observations and ripe reflection, Smith skillfully developed a body of doctrine which in finance, as in other departments of economic study, served as the foundation of most subsequent inquiry. Believing that one of the two objects of political economy is "to supply the state or commonwealth with a revenue sufficient for the public services," he devoted the fifth book of the Wealth of Nations to the "Revenue of the Sovereign or Commonwealth," and treated, in order, public expenditures, public revenues, and public debts.[1] Translated into one language after another, the Wealth of Nations exercised a profound influence upon economic thought in the leading countries of Europe; while it came, before long, to dominate the thought of Great Britain, and was extensively read in the United States. With many topics treated in the following chapters it will be necessary for us to begin by considering the doctrines of Adam Smith.

3. The Nineteenth Century. — In Great Britain after the time of Smith the systematic study of public finance seemed to languish. Writers of economic treatises continued to discuss taxation and public debts; but showed a tendency to confine themselves to questions of more or less abstract theory, and often relegated the subjects to a decidedly subordinate position.[2]

the "produit net" that taxation "should be placed immediately upon the revenue of the landed proprietor, and not upon commodities where it would multiply the cost of collection and injure commerce."

[1] The three chapters, or main divisions, of the fifth book recall clearly the three divisions of Bodin's chapter, *viz.* "honest means of raising revenues," methods of employing them, and reserving treasure for times of need. Smith placed expenditure first, as Petty had done, instead of second, as Bodin had preferred to do.

[2] James Mill (1821) treated of taxation while considering the consumption of wealth. John Stuart Mill (1848) discussed somewhat briefly taxation and national debts. Ricardo, on the other hand, entitled his most important work, Principles of Political Economy and Taxation (1817), and made important contributions to the theory of shifting and incidence.

Yet not a few important pamphlets or treatises were written upon special topics of immediate practical interest;[1] and, in 1845 McCulloch published his Treatise on Taxation and the Funding System, which, as the title indicates, deals systematically with two out of the three divisions of public finance recognized in the Wealth of Nations. Not until 1892 did the first real treatise upon finance appear in Great Britain; and this work still holds exclusive possession of the field,[2] although there has been an increased output of literature dealing with special parts of the science, particularly with taxation.[3]

In France during the nineteenth century financial studies followed practically the same course as in Great Britain. General treatises upon economics relegated financial topics to a subordinate position,[4] while there was a considerable output of meritorious works upon financial history and administration or other special subjects.[5] In 1862 Joseph Garnier brought out an unsatisfactory treatise upon public finance,[6] and somewhat later Paul Leroy-Beaulieu produced a decidedly superior manual which still ranks with the leading works upon our science.[7] France, too, has given us a very useful Dictionnaire des finances, edited by Léon Say, who, as student, administrator, and publicist, was one of the prominent features in French finance during the last quarter of the nineteenth century.

In Germany the study of finance had developed so far during the eighteenth century that the production of systematic treatises proceeded apace during the nineteenth. The first important development was the modification of many of the received cam-

[1] One of the most noteworthy was Robert Hamilton's Inquiry concerning the Management of the National Debt (1813).

[2] C. F. Bastable, Public Finance (third edition, 1903). R. H. Patterson's Science of Finance (1868) is not a treatise upon public finance.

[3] It should be observed that the fifth book of Professor Nicholson's extensive treatise, Principles of Political Economy (1893–1901), devotes not less than fourteen out of its twenty chapters to public expenditures, taxation, and public debts.

[4] J. B. Say (1803), for instance, treated expenditures, revenues, and public debts under the head of the consumption of wealth.

[5] Especially worthy of mention is René Stourm's Le budget (fourth edition, 1900).

[6] Traité des finances (fourth edition, 1883).

[7] Traité de la science des finances (sixth edition, 1899). Mention should be made, also, of the useful work by Jèze and Boucard, Éléments de la science des finances et de la législation financière française (second edition, 1901).

eralistic doctrines under the influence of the teachings of Adam Smith. This work was practically accomplished by 1832, when K. H. Rau published the first part of his Grundsätze der Finanzwissenschaft,[1] which for several decades remained the leading manual for university students and aspirants for administrative posts. After the middle of the century the influence of Smith began to decline, but not until his doctrines had left a permanent impress upon German financial science. Of the modern treatises the chief is Adolph Wagner's Finanzwissenschaft (1877–), which is still uncompleted, although four portly volumes have appeared. Of the shorter works, those by Roscher (fourth edition, 1894), Cohn (1889), and Eheberg (seventh edition, 1903) should be mentioned;[2] while we should not overlook the third volume of Schönberg's Handbuch der politische Oekonomie (fourth edition, 1896–98), which contains a valuable collection of monographs upon the various parts of public finance. Most of the German writers have studied with care existing financial institutions and their history, and public finance has received a noteworthy impetus from their labors.

While financial problems have demanded and received no little attention in the United States ever since the establishment of our national government, systematic study of public finance has been a comparatively recent development. In state papers or the writings of public men who have had to deal with questions of finance, a considerable body of literature has always existed,[3] but in wholly unsystematic form. Our earliest textbooks on economics accorded financial topics the same cursory treatment which they received at the hands of contemporary English or French writers. During the last forty years federal or state commissions appointed to consider urgent problems have published more or less elaborate reports upon taxation

[1] This, according to what has become the traditional German method, formed the third volume of Rau's Lehrbuch der politischen Oekonomie.

[2] The volumes by Roscher and Cohn are parts of larger treatises upon economics. Cohn's Finanzwissenschaft has been translated (Chicago, 1895). Eheberg's work is perhaps the most convenient for the student.

[3] Hamilton's Report on Public Credit (1790); Walcott's Report on Direct Taxes (1796); Gallatin's Sketch of the Finances of the United States (1796). For a much later period, may be mentioned John Sherman's Speeches and Reports on Finance and Taxation (1879).

and some other subjects, of which a few have been of high merit.[1] More recently there has been a gratifying increase of interest in finance,[2] as in other departments of economic investigation, which has given us a considerable number of special studies upon taxation,[3] public debts,[4] the financial history of our own country,[5] and various other subjects;[6] as well as three general treatises upon public finance.[7]

[1] The New York Commission of 1871 and 1872, the Maryland Commission of 1886, and the Massachusetts Commission of 1897 are examples of the reports dealing with taxation. The federal revenue system was searchingly investigated after the Civil War by Mr. David A. Wells, who, as commissioner of revenue, issued several reports.

[2] Of this perhaps the first signs were the numerous articles upon financial topics in Lalor's Cyclopædia of Political Science (1883–84) and the translation of Cossa's Scienza delle finanze, under the misleading title, however, of Taxation, its Principles and Methods (1888).

[3] Ely, Taxation in American States and Cities (1888); Seligman, Essays in Taxation (1895), The Shifting and Incidence of Taxation (second edition, 1899), Progressive Taxation (1894); Howe, Taxation in the United States under the Internal Revenue System (1896); Wells, Theory and Practice of Taxation (1900).

[4] Adams, Public Debts (1887); Ross, Sinking Funds (1892); Scott, The Repudiation of State Debts (1893).

[5] Works upon special parts of the field are too numerous to mention here. Of general works there are two: Bolles, Financial History of the United States (1879–1886); and Dewey, Financial History of the United States (1902).

[6] Urdahl, The Fee System in the United States (1898); Kinley, The Independent Treasury of the United States (1893); [illegible] Administration of City Finances in the United States (1901).

[7] Adams, The Science of Finance (1898); Daniels, Elements of Public Finance (1899); Plehn, Introduction to Public Finance (second edition, 1900).

CHAPTER II

GENERAL CONSIDERATIONS CONCERNING PUBLIC EXPENDITURES

4. Public and Private Business Compared. — The financial activity of a government, like that of an individual, is concerned with the expenditure of money. In other respects, however, such as the ends pursued and the means employed, public and private business offer many points of contrast which are well presented by Eheberg:[1]

1. The ends sought by the state reach far beyond the sphere of individual activity. The economic activity of an individual is limited to the effort to procure, by means of mental or physical labor, the material goods which are needed to support life and satisfy his higher wants. The purpose of the state, however, is, first and foremost, to provide immaterial goods which defy measurement in money and yet are the basis of all spiritual or material progress, such as legal security, the maintenance of peace and national independence, and the development of the economic life of the people.

2. In private business the ruling principle is special service and special payment: every service rendered receives its appropriate payment which is determined by mutual agreement between buyer and seller. But the services rendered by the state, in so far as they are of a general and immaterial kind, cannot be individualized and separately valued; so that special payment for special service is impossible. The payments which citizens make for services received from the state are not determined by contract, but by the authority of the state and according to norms which it establishes. Except in so far as it draws revenue from productive property which it owns, the state

[1] Finanzwissenschaft, Einleitung, § 3.

secures its income by compulsion; it possesses, that is, the right to demand the services of its citizens without payment, and to levy taxes upon the incomes or property of its subjects or other persons who happen to be within its jurisdiction.[1] . . .

3. The facts, that many of the services of the state are of an immaterial character and minister to intellectual or moral needs, and that many of them cannot be valued in terms of money, make it difficult or wholly impossible to compare the cost of production with the value of the product, as must be done in every well-ordered private business. While the payments which the citizens make in the form of taxes or duties can be readily calculated, the services rendered by the state cannot be reduced to figures. In this latter case an estimate can be formed only by a careful comparison of outlay with the results of expenditure. Often, too, it is necessary to observe the results achieved over a long period of time, since only then can it be determined whether the domestic or foreign policies to which the state devoted its revenues justified the sacrifices and met the expectations of the people — whether, that is, they contributed to spiritual and material progress. Such a comparison of the burden and the profit can best be made by an intelligent and unbiased representative assembly. . . .

4. A further peculiarity of public business is the unlimited duration of the elements with which it deals. Many expenditures for public purposes are made for the future as much as for the present.[2] For this reason it is just that future generations should bear part of the burden of important public works or the defense of the state against great dangers — a thing which is accomplished through the agency of public debts.

5. Finally, public business differs from private in that it is limited in respect to its outlay and its income. The outlay of

[1] Eheberg here alludes again to the fact that the state may have landed domains or public industries from which some revenue is raised. But he says that history shows that taxation has steadily increased in importance, at the expense of these revenues from domains and industries. — Ed.

[2] For this reason, as Wagner observes, "the state can undertake enterprises which no private business could attempt on account of the limited duration of its life." Finanzwissenschaft, I. 14–15. Even more important is the consideration that in private business a quick return from the investment is generally desired, whereas the state can afford frequently to sacrifice present to future returns. — Ed.

the state is limited by the range of the duties which are assigned it at any time; and the amount of its income depends upon the nature and extent of its outlay. While in private business the acquisition of wealth is not limited in this manner, the income of the state finds its measure in its financial needs. And while in private business expenses must be regulated by the income, the income of the state is determined, rather, by the amount of expenditures which are requisite. It is true that, in determining upon public expenditures, the possible revenue available should not be left out of consideration;[1] but within these limits the state regulates its income according to its expense.

5. The Economic Effects of Public Expenditure: Early Opinions. — The economic effects of public expenditure are far reaching. If the outlay is wisely directed, the economic life of the people may be greatly benefited,[2] while unwise expenditure tends to impoverish a country. But, besides these obvious direct effects, public expenditure produces certain important indirect results. No inconsiderable part of the income of society is taken by governments in the form of taxes,[3] and the expenditure of such enormous sums affects profoundly the direction which industry takes, and, sometimes, the rate of wages which must be paid in private occupations.[4]

[1] This qualification is strongly emphasized by Roscher, who quotes Frederick the Great as saying that a state will bankrupt itself if it adopts the policy of saying, "I need so much; raise the money," rather than, "I have so much money, and can therefore spend so much." Finanzwissenschaft, § 109. — Ed.

[2] This benefit, of course, is the justification of the expenditure. The first constitution of Pennsylvania (1776) declared that "the purpose for which any tax is to be raised ought to appear clearly to the legislature to be of more service to the community than the money would be, if not collected." This, perhaps, was suggested by the remark of Sir James Stewart: "If the money raised be more beneficially employed by the state, than it would have been by those who contributed it, then I say the public has gained. . . ." Inquiry into Political Economy (1767), Bk. V. ch. 7.

[3] Leroy-Beaulieu estimated some years ago that the taxes levied in various countries of Europe represented from 6 to 15 per cent of the income of the people. Traité, I. 133.

[4] Capital will flow naturally into those industries the products of which are in

But there is an old and very common fallacy, that governmental outlay is, in itself, a good thing, since it "puts money into circulation" and increases the demand for labor. Jean Bodin, for instance, in 1576, enlarged upon the advantages which come from the expenditure of the royal revenues upon public works: "For beyond the fact that such works are necessary, there result besides great benefits to the commonwealth; inasmuch as by this means the arts and artificers are supported, the poor are relieved, and dislike of taxes and duties is removed, when the prince restores to the public at large and to individual subjects the money he takes from them."

Not infrequently this fallacy is found in company with the mercantilist notion that no sort of expense is seriously detrimental provided the money be spent for goods of domestic production, and not for imported commodities.[1] Thus Sir William Petty argued that expenditures for public works should be increased because, among other things, indigent people can be employed thereon; and said: "Now as to the work of these supernumeraries, let it be without expence of Foreign Commodities, and then 'tis no matter if it be employed to build a useless Pyramid upon Salisbury Plain, bring the stones at Stonehenge to Tower-Hill, or the like. . . ." At the present day such errors recur persistently in popular discussions, usually in some such form as the following paragraph which appeared in a well-known newspaper in 1902: "What does the heedless throng know about the Philippine question, anyway; and what does it care? To be sure the army is costing the people millions

great demand for public purposes. So, too, if governments offer more than the market rate of wages for labor, the wages in private employments may be affected.

[1] Sir Thomas Mun, for instance, wrote concerning luxurious expenditure as follows: "Again the pomp of Buildings, Apparel, and the like, in the Nobility, Gentry, and other able persons, cannot impoverish the Kingdom; if it be done with curious and costly works upon our materials, and by our own people, it will maintain the poor with the purse of the rich. . . ."

annually, but it is furnishing employment for thousands of men who might otherwise be idle, and the army supplies are purchased in this country, while the money for munitions and ordnance is disbursed in America to Americans. The war gives employment to idle men and distributes money to the contractors who are manufacturers."

6. The Views of Smith and Say. — Although at least one of Petty's contemporaries perceived that such an idea was absurd,[1] it remained for Adam Smith to destroy the foundation of this as of other mercantilist theories. Smith showed[2] that all non-productive expenditure diminishes, so far forth, "the funds destined for the employment of productive labor," even though "the expence of the prodigal should be altogether in home-made, and no part of it in foreign commodities," the exportation or non-exportation of gold and silver making no material difference in the situation. Accordingly, while he considered it unnecessary to repeat the general principle, he argued that particular forms of public expenditure in no way increased the industry of the country or the employment given to labor. He says:[3] "By the reduction of the army and navy at the end of the late war, more than a hundred thousand soldiers and seamen, a number equal to what is employed in the greatest manufactures, were all at once thrown out of their ordinary employment; but, though they no doubt suffered some inconveniency, they were not thereby deprived of all employment and subsistence. The greater part of the seamen, it is probable, gradually betook themselves to the merchant-service as they could find occasion, and in the meantime both they and the soldiers were absorbed in the great mass of the people, and employed in a great variety

[1] In 1699, Charles Davenant remarked: "Some persons have a strange notion, that large payments to the state are not hurtful to the public; that taxes make money circulate; that it imports not what A pays when B is to receive it."

[2] Wealth of Nations, Bk. II. ch. 3; Cannan's edition, II. 320–322.

[3] Bk. IV. ch. 2; Cannan's edition, I. 434.

of occupations."[1] And similarly he contended[2] that the payment of interest upon the public debt was a burden upon industry even though the securities were all owned at home and no money left the country as a result of the operation.

A generation later Jean Baptiste Say, a disciple of Smith, developed the argument in greater detail:[3]

If I have made myself understood in the commencement of this third book, my readers will have no difficulty in comprehending, that public consumption or that which takes place for the general utility of the whole community, is precisely analogous to that consumption, which goes to satisfy the wants of individuals or families. In either case, there is a destruction of values, and a loss of wealth; although, perhaps, not a shilling of specie goes out of the country.

* * * * * * *

The government exacts from a taxpayer the payment of a given tax in the shape of money. To meet this demand, the taxpayer exchanges part of the products at his disposal for coin, which he pays to the taxgatherer: a second set of government agents is busied in buying with that coin cloth and other necessaries for the soldiery. Up to this point, there is no value lost or consumed; there has only been a gratuitous transfer of value, and a subsequent act of barter; but the value contributed by the subject still exists in the shape of stores and supplies in the military depot. In the end, however, this value is consumed; and then the portion of wealth which passes from the hands of the taxpayer into those of the taxgatherer, is destroyed and annihilated.

Yet it is not the sum of money that is destroyed: that has

[1] With England's experience after the Seven Years' War it is interesting to compare that of the United States after the Civil War. Mr. J. F. Rhodes says: "It is well worth repeating that in the six months from May to November, 1865, 800,000 men had changed from soldiers to citizens; and this change in condition was made as if it were the most natural transformation in the world. These soldiers were merged into the peaceful life of their communities without interruption to industry, without disturbance of social and moral order." History of the United States, V. 185–186.

[2] Bk. V. ch. 3; Cannan's edition, II. 412.

[3] Traité d'économie politique, Bk. III. ch. 6.

only passed from one hand to another, either without any return, as when it passed from the taxpayer to the taxgatherer; or in exchange for an equivalent, as when it passed from the government agent to the contractor for clothing and supplies. The value of the money survives the whole operation, and goes through three, four, or a dozen hands, without any sensible alteration; it is the value of the clothing and necessaries that disappears, with precisely the same effect as if the taxpayer had, with the same money, purchased clothing and necessaries for his own private consumption. The sole difference is, that the individual in the one case, and the state in the other, enjoys the satisfaction resulting from that consumption.

The same reasoning may be easily applied to all other kinds of public consumption. When the money of a taxpayer goes to pay the salary of a public officer, that officer sells his time, his talents, and his exertions, to the public, all of which are consumed for public purposes. On the other hand, that officer consumes, instead of the taxpayer, the value he receives in lieu of his services; in the same manner as any clerk or person in the private employ of the taxpayer would do.

There has been long a prevalent notion that the values, paid by the community for the public service, return to it again in some shape or other; in the vulgar phrase, that what government and its agents receive is refunded again by their expenditure. This is a gross fallacy; but one that has been productive of infinite mischief, inasmuch as it has been the pretext for a great deal of shameless waste and dilapidation. The value paid to government by the taxpayer is given without equivalent or return: it is expended by the government in the purchase of personal service, of objects of consumption; in one word, of products of equivalent value, which are actually transferred. Purchase or exchange is a very different thing from restitution.

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If, then, public and private expenditure affect social wealth in the same manner, the principles of economy, by which they should be regulated, must be the same in both cases. There are not two kinds of economy, any more than two kinds of honesty or morality. If a government consume in such a way as to

give birth to a product larger than that consumed, a successful effort of productive industry will be made. If no product result from the act of consumption, there is a loss of value, whether to the state or to the individual; yet, probably, that loss of value may have been productive of all the good anticipated. Military stores and supplies, and the time and labor of civil and military functionaries engaged in the effectual defense of the state, are well bestowed, though consumed and annihilated ; it is the same with them as with the commodities and personal service that have been consumed in a private establishment. The sole benefit resulting in the latter case is the satisfaction of a want; if the want had no existence, the expense or consumption is a positive mischief, incurred without an object. So likewise with the public consumption; consumption for the mere purpose of consumption, systematic profusion, the creation of an office for the sole purpose of giving a salary, the destruction of an article for the mere pleasure of paying for it, are acts of extravagance either in a government or an individual, in a small state or a large one, a republic or a monarchy. Nay, there is more criminality in public than in private extravagance and profusion; inasmuch as the individual squanders only what belongs to him; but the government has nothing of its own to squander, being, in fact, a mere trustee of the public treasure.

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Madame de Maintenon mentions, in a letter to the Cardinal de Noailles, that, when she one day urged Louis XIV to be more liberal in charitable donations, he replied, that royalty dispenses charity by its profuse expenditure; a truly alarming dogma, and one that shows the ruin of France to have been reduced to principle. False principles are more fatal than even intentional misconduct, because they are followed up with erroneous notions of self-interest, and are long persevered in without remorse or reserve. If Louis XIV had believed his extravagant ostentation to have been a mere gratification of his personal vanity, and his conquests the satisfaction of personal ambition alone, his good sense and proper feeling would probably, in a short time, have made it a matter of conscience to desist, or at any rate, he would have stopped short for his own sake; but he was firmly persuaded that his prodigality was for the public

good as well as his own; so that nothing could stop him but misfortune and humiliation.[1]

So little were the true principles of political economy understood, even by men of the greatest science, so late as the eighteenth century, that Frederick II of Prussia, with all his anxiety in search of truth, his sagacity, and his merit, writes thus to D'Alembert, in justification of his wars: "My numerous armies promote the circulation of money, and disburse impartially among the provinces the taxes paid by the people to the state." Again I repeat, this is not the fact; the taxes paid to the government by the subject are not refunded by its expenditure. Whether paid in money or in kind, they are converted into provisions and supplies, and in that shape consumed and destroyed by persons that can never replace the value, because they produce no value whatever. It was well for Prussia that Frederick II did not square his conduct to his principles. The good he did to his people, by the economy of his internal administration, more than compensated the mischief of his wars.

7. Dietzel's Theory of Public Expenditures. — In 1855 Karl Dietzel published a book in which he sought to controvert the views of Smith and Say concerning the effect of public expendi-

[1] "When Voltaire tells us, speaking of the superb edifices of Louis XIV., that they were by no means burdensome to the nation, but served to circulate money in the community, he gives a decisive proof of the utter ignorance of the most celebrated French writers of his day upon these matters. He looked no further than the money employed on the occasion; and, when the view is limited to that alone, the extreme of prodigality exhibits no appearance of loss; for money is, in fact, an item, neither of revenue, nor of annual consumption. But a little closer attention will convince us of the fallacy of this position, which would lead us to the absurd inference, that no consumption whatever has occurred within the year, whenever the amount of specie at the end of it is found to be nowise diminished. The vigilance of the historian should have traced the 900 millions of francs expended on the chateau of Versailles alone, from the original production by the laborious efforts of the productive classes of the nation, to the first exchange into money, wherewith to pay the taxes, through the second exchange into building materials, painting, gilding, &c. to the ultimate consumption in that shape, for the personal gratification of the vanity of the monarch. The money acted as a mere means of facilitating the transfers of value in the course of the transaction; and the winding up of the account will show a destruction of value to the amount of 900 millions of francs, balanced by the production of a palace, in need of constant repair, and of the splendid promenade of the gardens."

tures. His theories have exercised no small influence upon later German writers. Dietzel said, in part:[1]

Even if we should confine our attention to the production and consumption of material goods, as well as personal services, and were willing to exclude altogether immaterial goods, it would still be easy to show that the consumption of goods by a government is a thoroughly productive form of consumption. Besides other favorable conditions, productive industry needs, for its undisturbed and successful prosecution, protection against external forces which would otherwise disturb, delay, deteriorate, or annihilate the process of production. These disturbing factors may be either natural or human forces. The protection of industry against such disturbances is, therefore, a necessary condition of production; and the expenditures made for such a purpose must be considered productive.

With institutions designed to protect industry against natural forces this is beyond question, and is denied by no one. Factories, shops, and storehouses are, therefore, generally considered productive investments; for the product could not be obtained or its value would be reduced if industry were not protected against the possible destructive effects of rain, wind, or sun.

But it has not generally been perceived that the same is true of institutions designed to afford protection against human agencies. Human force, to be sure, is usually directed toward seizing upon the products of industry; but it often has the result of merely decreasing the value of the products, and decreases the labor force through drawing away the workmen to protect the land against attack. It often has the more lasting result of reducing labor power on account of injuries received in service, or of destroying it altogether.

Everything which is threatened with destruction, but finally saved, is virtually newly produced; in such a case we possess a thing which, without the protective institutions, we should not possess. These protective institutions, therefore, and the expenditure by which they are maintained, must be considered productive. This is true of protection of the products of labor and of the laborers themselves. Every expenditure by which a productive laborer is maintained is productive.

[1] Das System der Staatsanleihen, 11–15.

In small affairs we recognize this productivity of protective institutions without trouble, since we assign a shepherd to every herd and do not consider such expenditure unproductive. In large affairs, however, we do not recognize this, but deny to expenditures for public order and national defense the acknowledgment of their productivity.

The principal institution for the protection of society against the evil effects of violence by human agencies is the state. It protects the peaceful labor of citizens, and the products of such labor, against disturbance or destruction by domestic or foreign enemies. As little as the herd can dispense with the shepherd can society exist without government and its protective action.

Expenditure to procure domestic tranquillity and to defend persons and property against attack is, to be sure, less harshly judged than military outlay; its usefulness and the necessity of such public action is generally recognized. But should policemen be considered economically productive and the army unproductive? . . .

The unproductivity of expenditures for war is used as the chief argument against public borrowing because up to this time loans have been utilized for the most part to meet the great expenses of war. This view rests upon the assumption that the wars could have been avoided, which is a delusion. From the economic standpoint war, like any destructive outbreak of natural forces, seems to be the result of circumstances and forces which are actually operating in society and must be accepted as a given fact. For our economic life, therefore, the only possible course is to seek to make this power, like the forces of nature, useful or harmless, as the case may permit. When undertaken for the purpose of defense, war makes property secure and insures the orderly ongoing of productive undertakings; and all the wealth which, without its intervention, would have been destroyed or not produced, must be considered as produced with the coöperation of war. When it is a war of offense, it serves to obtain advantageous conditions for economic development or it averts future injuries to it. In both cases its purpose is to maintain or advance the national wealth. In the first case it secures valuable territory or favorably situated localities, or, as a commercial war, opens up avenues of

trade in regions previously closed. In the second it undertakes to maintain the balance of power, and to prevent the growth of other states which might later prove dangerous to the economic development of one's own land.

War is, therefore, under existing conditions, an event that inevitably occurs from time to time, and we should not consider it an extraordinary occurrence that wrongfully burdens industry and destroys its products. The outlay for war is one of the general costs of producing society. To diminish these costs and to provide for meeting such outlay with the least possible disadvantage to society, must be the leading economic principle in respect to war. It is realized by means of public loans.

If the state by means of borrowed capital undertakes great outlays for other purposes which immediately subserve the production of material wealth, this form of public consumption cannot be considered unproductive. This is true when it uses the money for constructing means of communication, roads, canals, railroads, and the like; and here the loans are not condemned on the ground that they encourage unproductive consumption. But could not the loans have been avoided, even in this case, if the state had limited or foregone other expenditures which are considered unproductive, as, for instance, outlay for public education and worship? These expenditures, however, are productive even so far as the production of material wealth is concerned. . . . Education improves the power of the workman to labor, and religion tends to uplift the people morally, thereby contributing to the safety of productive industry.

Elsewhere Dietzel says [1] that the state is a part of the "immaterial" capital [2] of the nation, and the most important of all the forms of immaterial capital. The state, he says, is "a relation which the whole body of the people has created by the expenditure of economic goods or labor, in order to contribute to the production of other goods," these being the "higher

[1] System der Staatsanleihen, 71, 99.

[2] "Immaterial" capital he defines as "all those relations and circumstances which exert a favorable influence upon economic society and increase its productivity, and which are created by the expenditure of economic goods."

development of society," and, in general, "the higher forms of goods." Dietzel then proceeds to argue:

This immaterial capital (the state) needs to be maintained intact, just like any other capital; and, as society progresses, must be continually increased if the equilibrium between the different parts of the whole capital of society is to be undisturbed. Every economic period must, therefore, make some expenditure for this purpose; expenditure which, according to the varying conditions of the different periods, may be of various amounts. While, then, we enjoy without expense so much of the life of the state as is an inheritance from the past, the outlay which our own generation makes for this purpose must be viewed as an investment of disposable private wealth in fixed capital which belongs to the whole community.

CHAPTER III

THE INCREASE OF PUBLIC EXPENDITURES IN MODERN TIMES

8. The Growth of Expenditures: Wagner's so-called Law. — That there has been a marked increase of public expenditures in modern times is an undoubted fact, but interpretations of this phenomenon differ widely. Professor Adolph Wagner, after examining the available data, laid down the following "law of the increase of state activities": [1]

Comprehensive comparisons of different countries and different times show that, among progressive peoples, with which alone we are concerned, an increase regularly takes place in the activity of both the central and the local governments. This increase is both extensive and intensive: the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely. In this way the economic needs of the people, to an increasing extent and in a more satisfactory fashion, are satisfied by the central and local governments. The clear proof of this is found in the statistics which show the increased needs of central governments and local political units.

9. A General Survey and Interpretation of the Facts: by Professor F. S. Nitti. — The increase of public expenditures has been so striking as to attract the attention of many writers,[2]

[1] Grundlegung der politischen Oekonomie, Bk. VI, ch. 3 (third edition, 1893).

[2] Besides Wagner and Nitti, the subject has been treated by Leroy-Beaulieu, Traité, Part II, Bk. I, ch. 6; Bastable, Public Finance, Bk. I, ch. 8; Adams, Science of Finance, Bk. I, ch. 4; Eheberg, Finanzwissenschaft, § 23; Ely, Evolution of Industrial Society, 315–330.

but no one has discussed it more instructively than Professor Nitti,[1] of the University of Naples:

As a matter of historical fact it cannot be disputed that the budgets of all countries show a continuous increase. France has been longer under a unified government than other European countries, and it is easier to follow changes in the French budget than in those of other nations. Now the French budget has steadily grown; the ordinary public revenue, stated in millions of francs, has been as follows:

Year	Revenue	Year	Revenue
1243	3.7	1607	90.8
1300	5.5	1648	184.0
1364	8.1	1683	226.0
1422	13.6	1715	266.0
1491	44.8	1756	253.0
1515	72.8	1789	475.0
1560	84.0		

We shall learn later on how far this increase is real, and how far it is merely nominal; for the present we are concerned with the fact that the figures show a noteworthy increase which becomes still more serious after 1789. If we continue our computation based upon the official documents, we shall perceive that the most extraordinary increase occurred in the nineteenth century:

(In millions of francs)

Year	Expenditure	Year	Expenditure
1798	750	1875	2,209
1810	1,007	1880	2,760
1830	1,095	1892	3,343
1850	1,473	1896	3,400
1860	2,084	1901[2]	3,554

* * * * * * *

England, by its geographical position, historical conditions, and the character of its inhabitants, has had forms of government very different from those found in France, together with a greater degree of local self-government. But in Great Britain the increase of both central and local expenditures has been as

[1] F. S. Nitti, Principi di scienza delle finanze, 64–100 (1903). Translated with permission of the author.

[2] Without Algerian expenses.

rapid as in France. A statement of the expense of the national government[1] will reveal clearly this increase:

(In millions of pounds)

Year	Amount	Year	Amount
1691	3	1875	74
1747	11	1882	85
1797	58	1892	89
1809	78	1898	102
1814 (war)	112	1900	118
1866	65	1902	142

The years following 1898 are years of war and not a fair basis for comparison; but the budget estimates for 1903 are eloquent, for although they show a great decrease of war expenses, they reveal a striking increase of expenditures that will prove permanent.

* * * * * * *

And in England this tendency is not confined to the national government. The expenses of the local governments have grown no less rapidly, indicating vigorous local activity. From 1868 to 1898 the local expenses increased even more rapidly than those of the national government:

(In millions of pounds)

Year	Amount	Year	Amount
1868	36.5	1890	69.3
1874	45.5	1896	91.6
1880	62.9	1899	111.7

Thus that country of all Europe which shows the greatest development of local government, England, and that one which shows the greatest centralization of power, France, do not differ materially in respect of the extraordinary increase of public expenditures. And similar results appear in other countries with various political or economic conditions.

But England, it may be said, has for more than a century waged wars in all parts of the world — has fought Napoleon, and contended for colonial empire in America, Asia, and Africa. France, too, has had great victories and great dis-

[1] These figures are not wholly comparable. The expenses of Ireland are sometimes excluded, and sometimes included.

asters, and has waged constant warfare. Perhaps, then, the situation is different with the countries that have followed a more peaceful policy — those which, on account of their small size or geographical situation, have less anxiety for their defense and less inclination for offensive war. Belgium, Switzerland, and Sweden, small in population, but centers of culture and civilization, and long exempt from war, may perhaps show conditions that differ from those in England and France.

In this view of the case, Belgium ought to be a happy exception; but her expenses have increased, none the less, even faster than those of France and England:[1]

(In millions of francs)

Year	Amount	Year	Amount
1835	87.1	1881	402.3
1841	114.9	1891	402.1
1851	118.6	1895	410.3
1861	163.4	1899	570.4
1871	222.5		

Switzerland, which has had no wars, which by reason of its small size can be a neutral state, but which is a remarkable center of activity and trade and a country with a democratic government, displays the same phenomenon of increasing public expenditures. From 1850 to 1896 the outlay of the Swiss Confederation increased as follows:

(In millions of francs)

Year	Amount	Year	Amount
1850	6.7	1880	41.0
1860	21.9	1890	66.6
1870	30.9	1896	79.5
1873	23.6	1899	98.0
1876	43.4	1900	102.7

And the expenses of the Swiss cantons have increased even more than those of the Confederation. From 1886 to 1896,

[1] It is necessary to remember, however, that in Belgium the railroads are operated by the state. Thus the department of public works in 1835 spent 4,200,000 francs. In 1899 the department of railroads, post, and telegraph (its new name dating to 1884) spent 147,800,000 francs. Nevertheless, even with the railroad expenses deducted, the growth of the Belgian budget has been enormous.

according to official documents, the expenses of the canton of Vaud have increased 33 per cent; those of Geneva, by 40 per cent; those of Basel, by 57 per cent; and those of Zurich, by 91 per cent. (Professor Nitti then presents figures for Holland and Sweden, both of them peaceful states, disclosing a marked increase of expenditures during the last fifty or sixty years.)

We can demonstrate, therefore, that the extraordinary growth of public outlay is not characteristic of the great states alone. It appears, indeed, to have no connection with the various political causes to which it has been attributed up to the present moment.

In greater or less degree the same increase has occurred in all the countries of Europe and America. This is a general phenomenon, especially since the beginning of the nineteenth century.

Germany, constituted an empire only in 1871, took over into the imperial budget only the expenditures for foreign affairs, posts and telegraphs, and the administration of the army and navy. Other branches of expenditure were left to the several states. Nevertheless the budget of the Empire has witnessed the following increase of its expense account:[1]

(In millions of marks)

Year	Amount	Year	Amount
1874	672.8	1894	1,269.0
1881	550.0	1897	1,255.0
1886	637.6	1900	1,960.5
1889	1,020.0	1901	2,197.3

The increase is enough to make one dizzy, the more so when we think of the enormous increase of the budgets of Prussia, Bavaria, Saxony, and all the other states that compose the Empire.

It has been said that democracy has been the principal cause of the costliness of government; but it appears that this statement lacks universal validity. Despotic or oligarchical governments do not appear to be less inclined to spend money, under

[1] A part of this increase, perhaps some 500,000,000 marks, is merely nominal, and is due to the growth of what may be termed bookkeeping transactions between the imperial government and the various German states. — Ed.

modern conditions, than democratic governments. According to official data, the ordinary expenditures of Russia have increased as follows:

(In millions of roubles)

Year	Amount	Year	Amount
1803	109.0	1860	438.0
1840	187.0	1880	793.0

But since 1880, according to official figures, the increase of ordinary outlay has been still more rapid and bewildering:

(In millions of roubles)

Year	Amount	Year	Amount
1881	840.2	1895	1,520.8
1890	1,056.5	1900	1,889.2

The increase of expenditures has been extraordinary, therefore, in Russia; they have increased, at least in appearance, to nineteen times the figures for 1803. Consequently we cannot say that under absolute government there is a tendency to check or to decrease expenditures, as has often been remarked; but it must be admitted that precisely the opposite is true. (Nitti then gives statistics for the United States, concerning which some data will be presented later, and for Japan.)

And we cannot say that this tendency is confined to national governments: local governing bodies of all classes have witnessed an increase of their expenditures as rapid as that of the national expenditures.

In Belgium provincial expenses rose from 5,773,680 francs in 1840 to 16,593,000 in 1899. Those of the Belgian communes advanced from 90,000,000 in 1865 to 179,000,000 in 1892.

We have already seen that in England local expenses increased from £26,000,000 in 1868 to £91,000,000 in 1896. If we take the budget of any large city, we shall discover the same fact. The City of Paris, which is like a small state, since it has more inhabitants than Denmark, Greece, or Norway, spends more than Portugal and Greece combined. Since 1813 its expenses have risen as follows:

(In millions of francs)

Year	Amount	Year	Amount
1813	23	1887	257
1869	168	1896	397

But Paris is the capital of the richest state of continental Europe. . . . Yet cities far inferior to it, far more modest centers of population, cities which have lost their former importance as capitals, show the same tendency. We possess an accurate history of the finances of Turin, published in 1901 by authority of the city government. This shows that expenses increased from 1797 to 1900 in the following manner:

YEAR	EXPENSES (in *lire*)	PER CAPITA EXPENSES
1797	547,300	5.88
1825	1,204,800	11.21
1855	5,266,400	31.36
1875	10,696,900	49.11
1900	15,912,800	48.40

Thus *per capita* local expenses have increased eightfold, while it is beyond question that the wealth of the people has not increased in the same proportion.

It is interesting to note that, between 1797 and 1900, the *per capita* expenditure for police and public health rose from 1.1 to 6.44 *lire;* those for public safety and justices, from 0.12 to 6.44 *lire;* those for public works, from 0.07 to 3.08 *lire;* those for public instruction, from 0.07 to 7.74 *lire.* Outlay for charity increased slightly, from 0.84 to 1.23 *lire;* while that for public worship declined from 0.16 to 0.05 *lira.* These figures indicate better than anything else could the causes which have determined their course.

Italy, in its turn, could not escape the general tendency. On the contrary it can be said that she has increased her expenditures excessively, reaching at times the extreme limits of pressure upon taxpayers.

We cannot carry our researches back of the year 1860. There were then as many budgets as states; and since states frequently changed not only their rulers but also their territories, and since all central authority was lacking, investigation is useless. . . . Limiting our inquiry, therefore, to the period following 1860, we find that even in Italy the increase of public expenditures — central as well as local — has continued:

PUBLIC EXPENDITURES IN ITALY[1]

(In millions of *lire*)

Year	National Government	Provinces	Communes
1863	930.4	25.7	223.9
1874	1,141.4	78.0	368.4
1885	1,481.4	98.7	451.6
1896	1,731.5	140.7	505.8
1898	1,640.8	117.1	554.0
1900	1,654.2	—	642.0

In Italy, then, the increase of outlays has been continuous; or, rather, we should say that there was no check to the increase for almost thirty years. Only after the expenses had grown to the extreme limit was there a sudden reaction, and then a slight reduction. But more recently expenditures have been on the increase.

Without doubt the increase of public expenditures is general; but it is necessary to inquire how far it is real, to inquire whether our figures are absolutely valid, and, if not, to ascertain what other elements need to be taken into account in order to present the facts in their true light.

Professor Nitti then proceeds to consider whether this apparent increase of public expenditures is real. He says:

Léon Say, in a little work which made considerable stir in 1886,[2] devoted several interesting pages to demonstrating that the growth of expenditures is a universal evil. Certainly no small alarm was aroused by the increase which occurred during the period when Say wrote. The expenses of all the countries of Europe, which amounted to 9,900,000,000 francs in 1865, had by 1879 exceeded 14,641,000,000. Two thirds of this increase was absorbed by the growth of military outlays, and one third by the development of public works and public education. The malady seemed to Say to be universal, and he fully believed that it was a real malady and one that was most dangerous in democratic countries. If comparisons extending over a few years

[1] Professor Nitti explains that the figures are not in all respects satisfactory, but that they are drawn from the best available sources. — Ed.

[2] This may be found in Vol. III. of Say's Finances de la France sous le 3me. République (Paris, 1900).

were startling, our surprise should be still greater when we compare the expenditures of former centuries with those of our own time. Some authors, and especially the German theorists, who attribute an ethical quality to state action, have believed that from the increase of public expenditures we can draw the conclusion that the sphere of state action constantly increases. And this increase of state functions, manifested by the increase of expenditures, has even made Bluntschli and some others affirm that there exists an historical tendency toward progressive state socialism. Nothing could be less true. The increase of public expenditures is more apparent than real so far as the more remote past is concerned; and it is only during the nineteenth century that a true increase occurred, but an increase less marked than is supposed.

The statistics can easily deceive us, for in economic affairs, as Bastiat has remarked, there is not only the "seen," but also the "unseen." And in dealing with budgets showing public expenditures it is necessary never to stop with the "seen."

To determine whether the sphere of state action is greater now than in the past, and whether the satisfaction of collective wants claims an increased proportion of our wealth, our calculation must be made in such a way as to avoid the errors into which people so often fall. In comparisons of past budgets it is necessary, in fact, to take account of the following factors: (1) the amount of the dues formerly paid in services or in kind; (2) the extent of the country's territory at the different times under consideration; (3) the population; (4) the amount of wealth belonging to private individuals; (5) variations in the value of money. It is only in this way that comparison can be made; otherwise our labors would be barren and without result.

We cannot, for example, compare the finances of feudal governments with those of modern. The former were based upon contributions in nature or in services, and upon income from domains; the latter are based upon public revenues from charges and taxes, especially the latter. Revenue from personal services is to-day unimportant; in the past it was the principal resource, in peace or in war, and public enterprises could not have been carried on without it. In feudal times, when war broke out,

every vassal sent to his suzerain a certain number of armed men. Forms of service varied very greatly, but they were numerous everywhere. To-day there is almost no sort of personal service except jury duty and military service, which is for a short period and undergoes constant reduction.

In the next place, we usually speak of Germany, England, and France as if they had always represented the same territorial units; whereas the formation of great states is a comparatively recent event which coincided with great geographical discoveries and the rise of new forms of international commerce. It was a slow process of unification which brought about the formation of the great states of to-day. The France of Henry IV was not the France of to-day; and still less was that of Philip the Fair. And Great Britain is not what she was in the time of Cromwell. . . .

And above all, the number of the population is the factor which has changed. The nineteenth century represents a period of increase such as has never, perhaps, had a parallel in the history of the world. The actual population is much greater than that of former times; never, perhaps, has the earth supported one half of the immense population which now crowds its surface. Europe had at the opening of the nineteenth century but one half of the inhabitants she had at the end of it; and all the countries of Europe have, to a greater or less extent, witnessed a considerable increase in the number of their inhabitants.

England, for example, is not only immensely richer than in former times, but is also far more populous. At about the year 1000 A.D. the British Isles did not have, in all probability, 3,500,000 inhabitants. England and Wales had only 5,500,000 in 1688; 6,000,000 in 1740; and less than 9,000,000 in 1801. Now, according to the census of 1901, the population of Great Britain is 41,600,000, while that of England and Wales is 32,500,000.

Sweden has witnessed an undoubted increase of public expenditures, but her population has advanced rapidly also. She had hardly 900,000 inhabitants in 1570; but in 1700 she had 1,500,000; in 1815, 2,500,000; and in 1900, 5,150,000. The population of Norway rose from 883,000 in 1800 to

2,122,400 in 1898. That of Prussia advanced from 13,707,000 inhabitants in 1800 to 31,855,000 in 1895. That of Italy grew from 17,000,000 in 1800 to 33,000,000 in 1900, and France, which according to the census of 1896 had 38,500,000 inhabitants, had but 20,000,000 at the beginning of the eighteenth century and less than 25,000,000 at the time of the Revolution. Some European countries to-day have a larger population than all Europe possessed in the time of Charlemagne.

But if population has advanced, wealth has increased still more. In Europe the annual revenue of every nation increased extraordinarily, to a degree almost incredible, during the nineteenth century; and the same is true of the United States of America. . . . The improvements in the technique of industry have been so great that the prevailing low prices of commodities could coincide with higher wages for labor. Certain countries in which the increase of wealth has been greatest, as Sweden, offer us the possibility of witnessing the wealth of each inhabitant grow more rapidly than his contributions to the support of the central and local governments.

The revenue of the French people has advanced remarkably. According to the investigations of the officials administering the direct taxes, the revenue drawn from the land advanced from 1,440,000,000 francs in 1791 to 4,671,000,000 francs in 1879. Revenues from personal property, which Délai d'Agier estimated at 1,050,000,000 francs in 1791, were, according to Wolowski, about 6,000,000,000 francs in 1881. Later calculations have shown a very rapid increase. . . .

Thus the increase of wealth in the most progressive countries has been such that the growth of public expenditures, startling as it is, does not greatly exceed it. Doubtless what we have said of Sweden, and what we could say of Great Britain, the United States, Germany, Switzerland, Belgium, and other rich countries, cannot be said of some countries in which it has actually happened that public expenditures have grown faster than the wealth of the inhabitants.

Let us continue, then, to study the growth of expenditures not only in its external features but in its economic reality. In proportion to their wealth, do the citizens contribute more to the support of government to-day, or did they contribute more in

former times? That is the question which we are considering; for it is of little consequence, in fact, to know if the mere quantity of money which the citizens contribute is greater or less than formerly.

Now all calculations agree in showing that money has lost no small part of its purchasing power. Money is worth less than formerly because with the same quantity of it one cannot purchase as much as in former times. . . .

During many centuries kings and their governments made continual alterations in their coinages, reducing the amount of metal which the coins contained while pretending to keep them intact. The *livre* of Charlemagne's time was actually a pound of silver, and it was only by successive debasements that it was reduced to the French *livre* and Italian *lira* of five grams. . . .

But we can study these changes and calculate them without difficulty. A more troublesome problem arises from the fact that not only have coins retaining the same names contained a smaller quantity of metal, but that also the purchasing power of the metal has fallen. In the time of Charlemagne, a given quantity of metal was worth nine times as much as it is to-day, that is, it would exchange for nine times as many commodities as at present. In the time of Charles VIII it was six times as valuable as at present; and in the middle of the eighteenth century three times as valuable. Thus a Frenchman who, in the time of Charles VIII, owed one franc in the money of the time, owed in reality six francs of our money.

* * * * * * *

If, then, we take all these elements into account, — if we recall the existence of various revenues from domains, take account of personal services, observe the changes in the territories controlled by the states, and allow for changes in wealth, population, and the purchasing power of money, when we compare present budgets with past, — we shall see that we are now contributing to the support of government, not much more than in the past, as has been claimed, but sometimes even less.

There does not exist, then, and no one has proved that there exists, a progressive tendency toward state socialism, as some have maintained. Perhaps there are some countries in which, after taking into account all the elements above mentioned, the

citizens are paying to the state proportionally less than in the past, although they are paying more money than formerly. In any case, if it is very difficult to draw comparisons with the remote past, we can make comparisons with times less remote. And it is necessary then to recognize that for a century public expenses, national and local, have increased much more than in former centuries, on account of the increased solidarity brought about by various causes. The increased expenditures of the nineteenth century are real increases; and in some way, despite the extraordinary increase of wealth, the citizens bear burdens which continually grow heavier.

Neither changes in the value of money nor changes in the income of the people explain fully the increases which appeared during the last half of the nineteenth century. The budgets of France, England, and Russia grew larger and larger, from year to year, by tens of millions, sometimes by hundreds. Now these increases are real, for in regard to them none of the qualifying factors above described has more than a temporary influence. What causes, then, produce these increases, which occasion such deep anxiety, and often disturb the equilibrium of the best balanced budgets? The increased expenditure of the nineteenth century, and especially of the last half of it, is real and is due chiefly to:

(a) *The continued growth of military expenditures.* — The statistics collected and published with so much care by Bloch in the famous book which led the Czar to call the conference at The Hague are certainly worthy of attention. For fifty years military expenditures have risen everywhere with a rapidity almost fantastic; and the increase has been as great in democratic as in monarchical countries. Under the most liberal governments, in England, Switzerland, and Sweden, the outlay has taken the same forms as in countries ruled by absolute monarchs. In earlier times there were many more wars, but they cost much less, from such items as the purchase of arms up to the equipment of soldiers. An iron head at the end of a long stick constituted a lance; and the arms and machines of war were generally simple. Modern arms are almost always expensive; a great steel cannon often costs more than the equipments for a whole battalion of soldiers in former times. The largest fleet

possessed by Athens cost less, perhaps, than a single modern warship. And then up to the Napoleonic wars there did not exist such vast permanent armies as we have to-day. War was the profession of a small number, and military apprenticeship was consequently a simpler matter. Expenses for war were small then, although frequent; there was more fighting, but the outlay was less. In our day peace itself costs the great powers more than the greatest war of antiquity ever cost. A modern war costs five or six billions, often more; and if wars do not often occur in Europe, it is because we now stop to think of the immense loss of men and treasure that would be occasioned thereby.

(b) *Great public works.* — It is only from about the middle of the nineteenth century that the use of steam and electricity as motor forces and the introduction of the electric telegraph upon a large scale occasioned a large increase of public expenditure. The world has never seen another transformation which could compare even remotely with that produced by steam and electricity. In this way, despite the enormous development of wealth in certain countries, the rate of interest has been kept up to a high point by reason of the demand for capital in the construction of public works, in addition to the demand in private industry which has continually assumed new and varied forms. In many countries the governments have constructed, upon their own account, in addition to public highways, which were rare almost everywhere at the beginning of the nineteenth century, tens of thousands of kilometers of railways and hundreds of thousands of kilometers of telegraph.

(c) *The growth of public debts.* — It is true that countries contract debts because they have expenses which they wish to make; but it is equally true that they could not make many expenditures if they could not borrow. And how the debts of the various countries have grown! In 1800 the nominal capital of the French debt was 713,000,000 *francs*; in 1891 it was 30,170,000,000, and in 1897 it was 31,093,000,000. In Italy the interest on the recorded debt at the time the kingdom was unified was 111,000,000 *lire*; the interest paid in the fiscal year 1897 was 556,000,000 *lire*. There is no country which does not resort largely, and even excessively, to borrowing. It would seem that, among the great states of Europe, England alone offers a

fortunate exception. She enjoys extraordinarily favorable natural conditions, and could, without difficulty, devote a part of her revenues to extinguishing old debts, rather than contract new ones. But even she, on account of her new policy, is resorting in large measure to loans.

(d) *The development of all forms of social prevention.* — These have increased the economic activity of the state. Formerly the state directed its action to repressing rather than preventing the most serious social ills that afflict society. To-day not only the social conditions have changed, but also the development of science leads us to adopt a different course. When activity was confined to healing or diminishing the evil, it was possible to rely upon individual effort; hospitals, charitable institutions, and asylums, created to cure or lessen the suffering which attracted attention and enlisted sympathy, could be created by individual initiative. But we do not ordinarily resort to individual effort when we adopt preventive methods. Thus hygienic or sanitary regulations, designed to prevent the evils, can only be undertaken by governments, central or local. General voluntary preventive action requires too great an educational and moral development ever to be wholly effectual.

(e) *The increasing participation of all the people in public affairs.* — Thanks to this, both national and local authorities have had to assume the burden of undertakings which formerly were not considered of general utility, or, at any rate, were neglected. It is true that the increase of public expenses has sometimes been more apparent in countries with absolute governments than among those with liberal institutions; but it cannot be denied that the latter have often led the way. Government of the nation by the nation, as de Rémusat remarked in 1832 in the French chamber of deputies, is not often economical government. An absolute government has frequently cost the people less, and, in order to maintain itself, has been known to reduce taxes even to the neglect of the public service. To-day, when the control of the government rests with the people and the expenses of sovereigns are separated from the public expenditures and form a separate item in the budget, people do not look upon taxation as a loss; in greatest part expenditures are truly *public* expenditures, since they are made

in the public interest. Under the constitutional governments which have succeeded the older absolute forms, it is not possible to consider the administration as an enemy, taxation as a scourge, and money paid to the state as money lost. . . . From any point of view it cannot be denied that, by having a share in public affairs, the masses of the people create expenses which formerly did not exist or existed on a very limited scale, such as expenses for compulsory public education, for the public health and social prevention, compulsory insurance, and the like, which did not previously exist. . . .

These then are the causes, the new conditions, which have brought about for a century a real increase of public expenditures.

10. The Growth of Federal Expenditures in the United States. — The facts concerning national expenditures in this country have been ascertained to be as follows: [1]

For the purposes of this article it will be desirable to exclude all the disbursements of the Post Office Department except the deficits paid out of the federal treasury, since the expenses defrayed from the ordinary postal revenues constitute no burden upon the taxpayers.[2] Then, for different reasons, we shall exclude all payments upon the principal of the public debt. These, of course, are a burden upon the taxpayers, but they show great variation from year to year according to the condition of the federal finances; and would have the effect, if they were included, of vitiating the comparisons that we shall attempt to make of the costs of running the federal government at various dates. By excluding this item the statistics for different years will be made strictly comparable, and this advantage is so great as to justify the omission, important as it is.

It is important first of all to secure a general view of the growth of expenditures since the formation of the national government. The following table begins with the year 1792

[1] The Growth of Federal Expenditures, by C. J. Bullock. Reprinted from the *Political Science Quarterly*, XVIII., pp. 97–111.

[2] Thus for the fiscal year 1900 we shall state the expenditures at $487,713,000, which includes the postal deficit. If the expenses defrayed out of departmental revenue were included, the total would reach $590,068,000.

because the official reports do not present separately the figures for 1789, 1790, and 1791:

EXPENDITURES OF THE UNITED STATES[1]

Year	Ordinary	Interest	Total	Per Capita
1792	$5,896,000	$2,373,000	$8,269,000	
1800	7,411,000	3,402,000	10,813,000	$2.04
1810	5,311,000	3,163,000	8,474,000	1.17
1820	13,134,000	5,151,000	18,285,000	1.90
1830	13,229,000	1,912,000	15,141,000	1.18
1840	24,139,000	174,000	24,313,000	1.42
1850	37,165,000	3,782,000	40,947,000	1.76
1860	60,056,000	3,144,000	63,200,000	2.01
1870	164,421,000	129,235,000	293,656,000	7.61 (6.80)[2]
1880	169,090,000	95,757,000	264,847,000	5.28
1886	191,903,000	50,580,000	242,483,000	4.22
1890	261,637,000	36,099,000	297,736,000	4.75
1900	447,553,000	40,160,000	487,713,000	6.39
1902	442,082,000	29,108,000	471,190,000	5.96

Even a cursory examination of these figures shows that the history of federal expenditures may be divided into five periods. The first of these extended from 1789 to 1811, and reflects the conditions that existed during the formative period of national finance. The ordinary expenditures steadily increased during the twelve years of Federalist rule, and culminated in 1800; after which the economies inaugurated under the Democratic régime resulted in a somewhat smaller outlay.[3] In a similar

[1] These figures are taken from the Report of the Secretary of the Treasury for the year 1901, pp. 131 and 133. They include the expenditures stated in the first and third columns of each page. They will be found to differ slightly from the statistics given on p. 113 of the same Report. For 1870, 1880, and 1890 the differences are due to the fact that our table excludes the item of "premiums" on debt. For 1840 and 1860 the differences are so slight as to be immaterial. For 1850 there is a difference of $1,404,000 which is not readily explained.

[2] The figures in the parenthesis show the per capita expenditures in specie. Interest payments were always made in gold, but the ordinary expenses are stated in currency values. Accordingly, I have reduced the latter to terms of gold before calculating the per capita outlay. For the fiscal year 1870 the greenbacks were worth 81 per cent of their face value.

[3] Yet in 1809 the ordinary expenditures rose to $7,414,000 on account of unusual outlays upon the army and navy.

manner the annual interest charge constantly rose until the year 1801, and then slowly declined as Gallatin was able to effect some reduction of the principal of the public debt. Between 1800 and 1810 there was a marked decline in the per capita cost of running the government, although, if our table included the sums applied in reducing the debt, the total burden borne by the people would not show so great a decrease.

Our second period extended from 1812 to 1860. Passing over the unusual conditions that prevailed during the early years of this epoch, we find that in 1820 both the ordinary expenditures and the interest charge had more than doubled,[1] while the per capita outlay had risen almost to the level reached in 1800. During the next fifteen years interest payments rapidly decreased, since the government accomplished the unprecedented feat of extinguishing the whole of the debt. But the ordinary expenditures never returned to their former proportions, and were permanently increased as a consequence of the War of 1812. In every instance in our history the prosecution of a war has entailed a similar result. The total expenditures of the government steadily decreased from 1820 to 1830 on account of reduced interest charges, and the per capita outlay of the latter year fell to the remarkably low level of 1810. After 1830 the ordinary expenses steadily increased, and the per capita cost of government gradually rose, especially after the Mexican War. By 1860 the federal expenditures had risen to $2.01 per capita, or practically the figures for the year 1800. Yet the increase of wealth had been such as to make the relative burdens of the taxpayers decidedly less than they were at the opening of the century. Upon the whole, during the first seventy years of our national existence, the federal government had been administered with remarkable economy, and at an expense that generally was considerably less than two dollars per capita.

The third period includes the decade 1861 to 1870. During the continuance of military operations the outlay of the government reached colossal proportions, but by 1870 conditions had become fairly normal so that one can form some estimate of

[1] Our table shows that interest payments rose only from $3,163,000 in 1810 to $5,151,000 in 1820. But the interest charge for 1812 was $2,451,000, so that the statement in the text represents correctly the results of the War of 1812.

the results of the war. Our table shows that interest charges had increased by $126,000,000; ordinary expenditures, by $104,000,000; and the per capita outlay, by $4.79, when the figures for 1870 are reduced to a gold basis. In other words, the Civil War had increased by over two hundred per cent the per capita cost of running the federal government, even when, as in our tables, the payment of the principal of the debt is left out of account.[1] And again, as in the case of the two earlier wars, the expenditure never afterwards fell to its former level.

Our fourth period embraces the sixteen years that terminated June 30, 1886. It witnessed the rapid reduction of our debt and a corresponding decline in the annual interest charge. Ordinary expenditures increased but slightly up to 1880, for the growth of pensions was offset by reduced outlays upon the army and navy. As a result there was a decrease in both the total and the per capita cost of government. After 1880 the growth of a large surplus revenue led to an increase of the ordinary expenditures, but this tendency was for some years more than counterbalanced by a reduction of the interest charge; so that in 1886 the total outlay had fallen to $242, 483,000, which represented a per capita burden of $4.22. This was the lowest point ever reached by the federal expenditures after the Civil War.[2]

During our fifth period, which extends from 1887 down to the present time, the reduction of interest charges has been too slight

[1] The facts are sufficiently striking to warrant detailed analysis in the following table:

Expenditures	1860	1870
Civil and Miscellaneous	$27,977,000	$53,237,000
War	16,472,000	57,656,000
Navy	11,515,000	21,780,000
Indian	2,991,000	3,408,000
Pensions	1,101,000	28,340,000
Interest	3,144,000	129,235,000
Total	$63,200,000	$293,656,000

[2] In 1877 and 1878 the total expenditures were slightly less than they were in 1886, but the per capita outlay was greater.

to offset the marked growth of expenditures in other directions; so that there has been a decided increase in the cost of maintaining the federal government. Between 1886 and 1893 the aggregate expenses rose from $242,483,000 to $383,477,000, while the per capita outlay advanced from $4.22 to $5.78. This was due chiefly to congressional extravagance fostered by a large surplus revenue. Then came four years of industrial depression, which produced a succession of deficits and enforced some degree of economy. The total expenditures were reduced from $383,477,000 in 1893 to $365,774,000 in 1897, in which year the per capita outlay stood at $5.11.[1] But then ensued the Spanish War, which has exerted a profound influence upon our finances, as upon other departments of our national life. In 1902 the total expenditures stood at $471,190,000, which represented a per capita burden of $5.96; while the estimates of the Secretary of the Treasury predict an increase of some forty or fifty millions for the fiscal year 1903. Once more we have an impressive demonstration that a war is practically certain to leave behind the legacy of larger expenditures, and that, too, even when it has not entailed a material increase of the public debt or a considerable addition to our pension rolls.

In many quarters a disposition exists to view with complacency the recent growth of federal expenditures. One well-known statistician has assured us that

> the federal government since the Civil War, which marked an exceptional period, has been doing just what a wise and judicious head of a family would do under increasing wealth and resources — keeping pace with environment, making improvements as the wealth of the country warranted, providing for great educational work, and carrying on extensive and expensive operations at home and abroad, but, nevertheless, increasing the burden of the people to such slight degree that it can hardly be felt.

[1] From 1886 to 1897 the expenditures were as follows:

Year	Ordinary	Interest	Total	Per Capita
1886	$191,903,000	$50,580,000	$242,483,000	$4.22
1893	356,213,000	27,264,000	383,477,000	5.78
1897	327,983,000	37,791,000	365,774,000	5.11

It is now proposed to invite the attention of the reader to an analysis of the statistics upon which the solution of the question must depend.

The course of federal expenditures during the last forty years is marked by a dividing line at the year 1886, when the outlay reached the lowest point ever known since the Civil War. In 1870 the per capita expense of running the government was $6.80, whereas sixteen years later it had decreased to $4.22. This means that the lowering of the annual interest charge, made possible by the reduction of the public debt, was sufficient to effect a decrease in both the total and the per capita expenditures, in spite of the growth of the outlay in other directions.[1] It is certainly true, as General Garfield contended in 1872,[2] that the *aggregate* expenditures could not decrease indefinitely in this manner, since a point would soon be reached at which the inevitable growth of the public needs would outweigh any further diminuation of the debts left by the war. But Mr. Garfield believed that the *per capita cost* of government might decline as population increased, even though the aggregate outlay could not remain stationary. However this may be, it is certain that the burden of the taxpayers in 1870 was excessive, since the per capita expense was more than three times as large as it had been ten years before. It is probable, also, that very few of those persons who view with complacency the recent growth of expenditures would care to deny that the country was benefited by the constant reduction of the per capita charges down to 1886.

[1] The facts may be shown by the following table:

	1870	1886	
Pensions	$28,340,000	$63,404,000	
Army and Navy	79,436,000	48,232,000	
Other	56,645,000	80,266,000	
	$164,421,000	$191,902,000	(Inc. $27,481,000)
Interest	129,235,000	50,580,000	(Dec. $78,655,000)
Total	$293,656,000	$242,482,000	(Dec. $51,174,000)

[2] See Congressional Globe, 42d Congress, 2d session, p. 538.

The real question at issue concerns the rapid growth of expenditures for the last sixteen years, during which the per capita outlay has increased from $4.22 to $5.96, or something more than forty per cent. It can be decided only by a detailed analysis that will show what has become of the additional outlay, which amounts to $1.74 for every man, woman, and child in the United States, or $8.70 for every family of five persons. The facts can be presented in simplest form by constructing two tables, of which the first will show the changes effected between 1886 and 1897, and the second will exhibit the results for the last five years. The first table, stating the expenditures, will stand as follows:

YEAR	PENSIONS	INTEREST	ARMY AND NAVY[1]	ALL OTHERS
1886 . . .	$63,404,000	$50,580,000	$44,142,000	$84,354,000
1897 . . .	141,053,000	37,791,000	69,826,000	117,099,000
	(Inc.) 77,649,000	(Dec.) 12,789,000	(Inc.) 25,684,000	(Inc.) 32,745,000

The increase of $25,687,000 in our military expenditures was due mainly to the creation of our new navy, and calls for little or no criticism. The growth of the various outlays for civil purposes, shown in the last column, averaged less than $3,000,000 for each year and may not have been greatly excessive, although the figures could probably have been reduced by more economical management. The aggregate increase in these two departments was $58,430,000, which was offset in part by a reduction of $12,789,000 in interest charges; so that the net growth of expenditures for the three items was but $45,640,000. Now if the pension outlay had stood at the figures for 1886, the government would have expended but $288,120,000 in 1897, and the per capita charges would have been but $4.02, or a reduction of twenty cents for the eleven years.

It is evident, therefore, that our per capita expenditures in 1897 might have been $4.02 instead of $5.11 had it not

[1] From the army and navy expenditures I have excluded the sums spent in improving rivers and harbors, which our Finance Reports assign to the War Department. These improvements are included with the civil expenditures shown in the last column.

been for the growth of pension disbursements by the sum of $77,649,000, and our judgment concerning the propriety of the growth of federal expenditures during the eleven years in question will depend upon the views we entertain concerning pension legislation. It is idle to talk about the government's "keeping pace with environment, making improvements as the wealth of the country warranted, providing for great educational work," etc.; for all such outlays, with the cost of the new navy thrown in, would not have increased the country's per capita expenses for 1897 over those for the year 1886. It is not the purpose of this paper to enter upon an extended discussion of pension legislation, but two things should be said in this connection. In a speech delivered in Congress on January 23, 1872, at a time when the pension roll called for an expenditure of only $28,533,000, General Garfield said: "We may reasonably expect that the expenditures for pensions will hereafter steadily decrease, unless our legislation should be unwarrantably extravagant." In 1886 the outlay was over twice as large as when these words were uttered, and it is evident that, unless General Garfield's calculations contained an error of over one hundred per cent, the growth of pension disbursements in recent years has been both extravagant and unwarranted. This conclusion will be strengthened if one notes that the legislation which brought about such a result was passed at a time when the federal treasury was groaning under an unprecedented accumulation of surplus revenue that was a direct incentive to extravagant appropriations. How probable is it that Congress would have passed the law of 1890 if it had been necessary to levy new taxes in order to provide ways and means? In any event it is useless to try to conceal the fact that pension expenditure was the cause of the increased per capita outlay in 1897.

We may now examine the second table, which shows the movement of federal expenditures from 1897 to 1902:

Year	Pensions	Interest	Army and Navy	All Others
1897	$141,053,000	$37,791,000	$69,826,000	$117,099,000
1902	138,488,000	29,108,000	165,128,000	138,465,000
	(Dec.) 2,565,000	(Dec.) 8,683,000	(Inc.) 95,302,000	(Inc.) 21,366,000

It will be observed that the outlay for pensions and interest decreased by $11,248,000, while that for all civil purposes rose to the extent of $21,366,000, a net increase of $10,118,000 for the three items. It is evident, therefore, that, if the cost of the army and navy had remained at the figures for the last year before the Spanish War, the aggregate expenditures of the United States would have increased from $365,774,000 to not more than $375,892,000 between 1897 and 1902. This would have given us a per capita outlay of $4.75 in the latter year as compared with $5.11 in the former. That the total expenditures were $471,190,000 is due solely to the growth of the outlay for military purposes. At present our army and navy are costing the country $95,302,000 more than before the recent war, and entail an additional outlay of $1.21 for every person in the country. For 1903 the prospect is that there will be a further increase of these expenditures.

It has long been the boast of Americans that this country has been relatively free from the heavy exactions that militarism has made upon the people of other lands. In 1889 the per capita cost of maintaining land and naval armaments was found to stand as follows in the leading nations of Europe:[1]

Austria	$1.99	Germany	$2.27	France	$4.16
Russia	2.13	Italy	2.56	England	4.23

European conditions have not improved during the last decade, so that the people of this country still have some reason for satisfaction over their more fortunate situation. And, when the indirect loss occasioned by the withdrawal of labor from productive industry is taken into account, the comparison results still more favorably for the United States. Yet we have less reason for satisfaction than we had a decade ago, as will appear from the following statistics, which show the cost of maintaining our army and navy in recent years:[2]

[1] Schönberg, Handbuch der Politischen Oekonomie (third edition), III, 49.

[2] Here, again, expenditures for improving rivers and harbors are deducted from the amounts charged to the War Department.

Year	Total Expenditures	Per Capita
1880	$43,640,000	$0.87
1890	54,851,000	0.88
1897	69,826,000	0.98
1902	165,128,000	2.09

The facts just presented are designed solely to furnish materials for a comparison of the outlays upon actual military armaments in this and in other countries. They convey no idea, however, of what war has cost and is costing the United States. For this purpose it is necessary to add to the expenditures upon the army and navy the burden entailed by the disbursements for interest [1] and pensions. Even then the figures which are now to be presented will not disclose the whole truth, since we have excluded throughout the important item of payments on the principal of the national debt.

Turning then to the aggregate running expenses chargeable to the account of war, the following statistics are presented:

Year	Army and Navy	Pensions	Interest	Total
1870	$79,435,000	$28,340,000	$129,235,000	$237,010,000
1880	43,640,000	56,777,000	95,757,000	196,174,000
1890	54,851,000	106,936,000	36,099,000	197,886,000
1897	69,829,000	141,053,000	37,791,000	248,673,000
1900	172,009,000	140,877,000	40,160,000	353,046,000
1902	165,128,000	138,488,000	29,108,000	332,724,000

And if now the total outlay for such purposes is compared with the entire amount of the federal expenditures, the result will be as follows:

[1] It should be remarked that, in 1894 and 1895, $262,000,000 of bonds were issued in order to maintain the gold reserve. Interest on this portion of the debt should properly be excluded from our figures, but the recent refunding operations make this an impossible task. But any error at this point is partly counterbalanced by the fact that we have not included in the military expenditures a sum, varying from $2,000,000 to $3,000,000, expended annually for maintaining the War and Navy Departments at Washington, which the Finance Reports group with the civil expenditures.

Year	Total	War	Per Cent
1870	$293,656,000	$237,010,000	80.7
1880	264,847,000	196,174,000	74.0
1890	297,736,000	197,886,000	66.4
1897	365,774,000	248,673,000	68.0
1900	487,713,000	353,046,000	72.4
1902	471,190,000	332,724,000	70.6

Thus it appears that our federal government is, on its financial side, mainly a huge machine for collecting taxes in order to defray the direct and indirect cost of war; so that the people of the United States should not congratulate themselves unduly upon their immunity from the burden which war entails.

As a matter of fact, it will probably startle the average reader to learn how little the federal government would cost were it not for war and its consequences. From the beginning of our national existence down to the present day the aggregate civil expenses of the United States have been comparatively small. This fact can be most readily shown by the following table, which gives the per capita charges first for civil expenditures and second for all purposes:

Year	Civil	All Purposes	Year	Civil	All Purposes
1800	$0.25	$2.04	1860	$0.98	$2.01
1810	0.18	1.17	1870	1.19	6.80
1820	0.30	1.90	1880	1.36	5.28
1830	0.30	1.18	1890	1.59	4.75
1840	0.48	1.42	1900	1.76	6.39
1850	0.76	1.76	1902	1.75	5.96

In these figures even the most warlike may find food for reflection. Our national government in 1902 was imposing upon taxpayers a burden that averaged $29.80 for every family of five persons. Of this sum, only $8.75 was needed for all civil expenditures, while $21.05 must be charged to the account of war.[1]

[1] The article then proceeds to consider the claim that, even if expenditures have increased, the increase has not been as rapid as the growth of wealth. It finds that from 1890 to 1900 both the total and the per capita expenditures increased faster than wealth.

CHAPTER IV

PUBLIC REVENUES: THE VIEWS OF BODIN AND SMITH

11. Bodin's Classification of Revenues. — In 1576 Jean Bodin, in the most extensive survey which had then been made of the subject, classified public revenues in the following manner:

> Now there are in general seven ways of raising public revenues,[1] which include all that can be thought of. The first is the landed domain of the commonwealth; the second, conquests from enemies; the third, gifts from friends; the fourth, tributes from subject states; the fifth, public traffic or trading; the sixth, customs duties upon merchants who bring in or carry out merchandize; and the seventh, taxes upon the citizens.[2]

Of these seven branches of revenue Bodin pronounced the first "the most just and certain of all." He contended stoutly that "in order that princes might not be obliged to lay taxes upon their subjects, or invent methods of seizing upon private property, all states and rulers have held it to be an indubitable general principle that the public domains should be holy, sacred, and inalienable, either by grant or by prescription." Moreover, he said, "it is not lawful for princes, even in time of peace, to squander the fruits and revenues of the domains; because they are entitled only to the usufruct of the domains, and ought, after providing for public needs and their own private expenses, to keep the surplus income for times of public necessity." Then, too, he believed that domains, when sold, usually brought less than their true value; and that, most important of all, the money

[1] For public revenues Bodin wrote *fonds aux finances.*

[2] Les six livres de la république, VI, 2.

derived from such sales is not invested, but "most often dissipated and given to those who have least deserved it."

The second, third, and fourth branches of revenue recognized by Bodin are not of great importance to the modern student of finance. Concerning the fifth, Bodin remarked that, although trade was despised by many, "it is more seemly for a prince to be a merchant than a tyrant, and for a gentleman to traffic than to steal."[1] The kings of Portugal, he said, had for a century drawn great riches from the East; while various Italian princes had carried on gainful traffic. Yet he observed that when a prince traded with his subjects the result was often a royal monopoly, by which the subjects were virtually taxed through extortionate charges.

The sixth branch of revenue — duties on imports and exports — Bodin pronounced "one of the oldest and most common resources in all states, and thoroughly just, because it is right that one who wishes to gain a profit from trade with another country than his own should pay duties to the prince." In this passage Bodin reflects the common opinion of his age that duties upon imports and exports are borne by the merchant, not by his customers; and he justifies them on the ground that it is right that a foreigner should contribute to the support of a government which permits him to come within its jurisdiction and trade with its citizens.[2] In fact, he did not regard customs duties as a form of taxation, and looked upon them as a kind of revenue which could be raised without burden to a prince's subjects.[3]

[1] Carafa, on the other hand, had opposed public trading. He said that this was undignified for a prince; that public business would not be so well managed as private; that the welfare of the subjects might be sacrificed to the profit of the prince.

[2] Throughout Europe our modern customs duties were, by a more or less obscure process, evolved from mediæval tolls and charges which travelers, especially merchants, were required to pay, nominally for the service of the sovereign in protecting them or maintaining roads and bridges.

[3] Yet in one place Bodin says that duties on necessities of life may be so heavy as to prove a burden.

Taxes form the last item in Bodin's classification. He considered them justified if "all other means are insufficient and there is urgent necessity of providing for the state"; but argued that no prince had the right to levy taxes on his subjects without their consent, and believed that taxation should be an extraordinary financial resource. Like his predecessors, he thought that in ordinary times the other revenues should suffice for the needs of the prince; and long after his time many writers continued to indulge in the illusion that taxation might be reserved for unusual emergencies.

12. Smith's Classification and Discussion. — Modern discussions of this subject have generally started from Adam Smith's chapter on the "Sources of the General or Public Revenue of the Society." Smith said:

> The revenue which must defray, not only the expense of defending the society and of supporting the dignity of the chief magistrate, but all the other necessary expenses of government, for which the constitution of the state has not provided any particular revenue, may be drawn, either, first, by some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people; or, secondly, from the revenue of the people.
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> * * * * * * *
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> The funds or sources of revenue which may peculiarly belong to the sovereign or commonwealth consist either in stock[1] or in land.
>
> The sovereign, like any other owner of stock, may derive a revenue from it, either by employing it himself, or by lending it. His revenue is in the one case profit, in the other interest.
>
> The revenue of a Tartar or Arabian chief consists in profit. It arises principally from the milk and increase of his own herds and flocks, of which he himself superintends the management, and is the principal shepherd or herdsman of his own horde or tribe. It is, however, in this earliest and rudest state of civil

[1] By "stock" Smith means capital. — Ed.

government only that profit has been made to form the principal part of the public revenue of a monarchical state.

Small republics have sometimes derived a considerable revenue from the profit of mercantile projects. The republic of Hamburgh is said to do so from the profits of a public wine cellar and apothecary's shop. The state cannot be very great of which the sovereign has leisure to carry on the trade of a wine merchant or apothecary. The profit of a public bank has been a source of revenue to more considerable states. It has been so, not only to Hamburgh, but to Venice and Amsterdam. A revenue of this kind has even, by some people, been thought not below the attention of so great an empire as that of Great Britain. Reckoning the ordinary dividend of the Bank of England at five and a half per cent, and its capital at £10,780,000, the net annual profit, after paying the expense of management, must amount, it is said, to £592,900. Government, it is pretended, could borrow this capital at three per cent interest, and by taking the management of the bank into its own hands, might make a clear profit of £269,500 a year. The orderly, vigilant, and parsimonious administration of such aristocracies as those of Venice and Amsterdam, is extremely proper, it appears from experience, for the management of a mercantile project of this kind. But whether such a government as that of England (which, whatever may be its virtues, has never been famous for good economy; which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is, perhaps, natural to monarchies; and, in time of war, has constantly acted with all the thoughtless extravagance that democracies are apt to fall into) could be safely trusted with the management of such a project, must, at least, be a good deal more doubtful.

The post office is properly a mercantile project. The government advances the expense of establishing the different offices, and of buying or hiring the necessary horses or carriages, and is repaid with a large profit, by the duties upon what is carried. It is, perhaps, the only mercantile project which has been successfully managed by, I believe, every sort of government. The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain, but immediate.

Princes, however, have frequently engaged in many other mercantile projects, and have been willing, like private persons, to mend their fortunes by becoming adventurers in the common branches of trade. They have scarce ever succeeded. The profusion with which the affairs of princes are always managed, renders it almost impossible that they should. The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another. Those agents frequently live with the profusion of princes, and sometimes, too, in spite of that profusion, and by a proper method of making up their accounts, acquire the fortunes of princes. It was thus, as we are told by Machiavel, that the agents of Lorenzo of Medicis, not a prince of mean abilities, carried on his trade. The republic of Florence was several times obliged to pay the debt into which their extravagance had involved him. He found it convenient, accordingly, to give up the business of merchant, the business to which his family had originally owed their fortune, and in the latter part of his life, to employ both what remained of that fortune and the revenue of the state of which he had the disposal, in projects and expenses more suitable to his station.

No two characters seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders them very bad sovereigns, the spirit of sovereignty seems to have rendered them equally bad traders. While they were traders only, they managed their trade successfully, and were able to pay from their profits a moderate dividend to the proprietors of their stock. Since they became sovereigns, with a revenue, which, it is said, was originally more than three millions sterling, they have been obliged to beg the extraordinary assistance of government in order to avoid immediate bankruptcy. In their former situation, their servants in India considered themselves as the clerks of merchants; in their present situation, those servants consider themselves as the ministers of sovereigns.

A state may sometimes derive some part of its public revenue from the interest of money as well as from the profits of stock. If it has amassed a treasure, it may lend a part of that treasure, either to foreign states or to its own subjects.

The canton of Berne derives a considerable revenue by lending a part of its treasure to foreign states; that is, by placing it in the public funds of the different indebted nations of Europe, chiefly in those of France and England. The security of this revenue must depend, first, upon the security of the funds in which it is placed, or upon the good faith of the government which has the management of them; and, secondly, upon the certainty or probability of the continuance of peace with the debtor nation. In the case of a war, the very first act of hostility, on the part of the debtor nation, might be the forfeiture of the funds of its creditor. This policy of lending money to foreign states is, so far as I know, peculiar to the canton of Berne.

The city of Hamburgh has established a sort of public pawn-shop, which lends money to the subjects of the state, upon pledges, at six per cent interest. The pawn-shop, or Lombard, as it is called, affords a revenue, it is pretended, to the state of 150,000 crowns, which, at 4*s.* 6*d.* the crown, amounts to £33,750 sterling.

The government of Pennsylvania, without amassing any treasure, invented a method of lending, not money, indeed, but what is equivalent to money, to its subjects. By advancing to private people, at interest, and upon land security, to double the value, paper bills of credit, to be redeemed fifteen years after their date, and, in the meantime, transferable from hand to hand like bank notes, and declared by act of assembly to be a legal tender in all payments from one inhabitant of the province to another, it raised a moderate revenue, which went a considerable way toward defraying an annual expense of about £4,500, the whole ordinary expense of that frugal and orderly government. The success of an expedient of this kind must have depended upon three different circumstances: first, upon the demand for some other instrument of commerce, besides gold and silver money; or, upon the demand for such a quantity of consumable stock, as could not be had without sending abroad the greater part of their gold and silver money, in order to purchase it; secondly, upon the good credit of the government which made use of this expedient; and, thirdly, upon the moderation with which it was used, the whole value of the paper bills of credit never exceeding that of the gold and silver

money which would have been necessary for carrying on their circulation, had there been no paper bills of credit. The same expedient was upon different occasions adopted by several other American colonies; but, from want of this moderation, it produced, in the greater part of them, much more disorder than conveniency.

The unstable and perishable nature of stock and credit renders them unfit to be trusted to as the principal funds of that sure, steady, and permanent revenue, which can alone give security and dignity to government. The government of no great nation that was advanced beyond the shepherd state seems ever to have derived the greater part of its public revenue from such sources.

Land is a fund of a more stable and permanent nature; and the rent of public lands, accordingly, has been the principal source of the public revenue of many a great nation that was much advanced beyond the shepherd state. From the produce or rent of the public lands, the ancient republics of Greece and Italy derived for a long time the greater part of that revenue which defrayed the necessary expenses of the commonwealth. The rent of the crown lands constituted, for a long time, the greater part of the revenue of the ancient sovereigns of European states.[1]

War, and the preparation for war, are the two circumstances which in modern times occasion the greater part of the necessary expense of all great states. But in the republics of Greece and Italy, every citizen was a soldier, who both served and prepared himself for service at his own expense. Neither of these two circumstances could occasion any very considerable expense

[1] Cohn remarks that the "German princes of the sixteenth, seventeenth, and even the eighteenth centuries regarded themselves as great landowners and landlords;" so that, in fact, "the administration of domains and forests was or was becoming the central point of their financial policy." In Prussia, as late as 1740, the prevailing opinion was "that the greatest conceivable stretch of taxation would not alone suffice to support the state and the army;" so that it was believed necessary to enlarge the domains and derive the largest possible revenue from them. In the southwestern states of Germany, also, the governments managed, even until the end of the eighteenth century, to get along without regular taxation in times of peace. Cohn, Finanzwissenschaft, § 59. In France and England the kings followed a less thrifty policy, and after the sixteenth and seventeenth centuries revenues from domains were of little importance. — Ed.

to the state. The rent of a very moderate landed estate might be fully sufficient for defraying all the other necessary expenses of government.

In the ancient monarchies of Europe, the manners and customs of the times sufficiently prepared the great body of the people for war; and when they took the field, they were, by the condition of their feudal tenures, to be maintained either at their own expense, or at that of their immediate lords, without bringing any new charge upon the sovereign. The other expenses of government were, the greater part of them, very moderate. The administration of justice, it has been shown, instead of being a cause of expense, was a source of revenue. The labor of the country people, for three days before and for three days after harvest, was thought a fund sufficient for making and maintaining all the bridges, highways, and other public works, which the commerce of the country was supposed to require. In those days, the principal expense of the sovereign seems to have consisted in the maintenance of his own family and household. The officers of his household, accordingly, were then the great officers of state. The lord treasurer received his rents. The lord steward and lord chamberlain looked after the expenses of his family. The care of his stables was committed to the lord constable and the lord marshal. His houses were all built in the form of castles, and seem to have been the principal fortresses which he possessed. The keepers of those houses or castles might be considered as a sort of military governors. They seem to have been the only military officers whom it was necessary to maintain in time of peace. In those circumstances the rent of a great landed estate might, upon ordinary occasions, very well defray all the necessary expenses of government.

In the present state of the greater part of the civilized monarchies of Europe, the rent of all the lands in the country, managed as they probably would be if they all belonged to one proprietor, would scarce, perhaps, amount to the ordinary revenue which they levy upon the people even in peaceable times. The ordinary revenue of Great Britain, for example, including not only what is necessary for defraying the current expense of the year, but for paying the interest of the public debts, and

for sinking a part of the capital of those debts, amounts to upward of ten millions a year. But the land tax, at four shillings in the pound, falls short of two millions a year. This land tax, as it is called, however, is supposed to be one fifth, not only of the rent of all the land, but of that of all the houses, and of the interest of all the capital stock of Great Britain, that part of it only excepted which is either lent to the public, or employed as farming stock in the cultivation of land. A very considerable part of the produce of this tax arises from the rent of houses and interest of capital stock. The land tax of the city of London, for example, at four shillings in the pound, amounts to £123,399, 6*s.* 7*d.* That of the city of Westminster, to £63,092, 1*s.* 5*d.* That of the palaces of Whitehall and St. James's, to £30,754, 6*s.* 3*d.* A certain proportion of the land tax is in the same manner assessed upon all the other cities and towns corporate in the kingdom, and arises almost altogether, either from the rent of houses, or from what is supposed to be the interest of trading and capital stock. According to the estimation, therefore, by which Great Britain is rated to the land tax, the whole mass of revenue arising from the rent of all the lands, from that of all the houses, and from the interest of all the capital stock, that part of it only excepted which is either lent to the public or employed in the cultivation of land, does not exceed ten millions sterling a year, the ordinary revenue which government levies upon the people even in peaceable times. The estimation by which Great Britain is rated to the land tax is, no doubt, taking the whole kingdom at an average, very much below the real value; though in several particular counties and districts it is said to be nearly equal to that value. The rent of the lands alone, exclusive of that of houses and of the interest of stock, has by many people been estimated at twenty millions, an estimation made in a great measure at random, and which, I apprehend, is as likely to be above as below the truth. But if the lands of Great Britain, in the present state of their cultivation, do not afford a rent of more than twenty millions a year, they could not well afford the half, most probably not the fourth part of that rent, if they all belonged to a single proprietor, and were put under the negligent, expensive, and oppressive management of his factors and agents. The crown lands of Great Britain

do not at present afford the fourth part of the rent which could probably be drawn from them if they were the property of private persons. If the crown lands were more extensive, it is probable they would be still worse managed.

The revenue which the great body of the people derives from land is in proportion, not to the rent, but to the produce of the land. The whole annual produce of the land of every country, if we except what is reserved for seed, is either annually consumed by the great body of the people, or exchanged for something else that is consumed by them. Whatever keeps down the produce of the land below what it would otherwise rise to, keeps down the revenue of the great body of the people still more than it does that of the proprietors of land. The rent of land, that portion of the produce which belongs to the proprietors, is scarce anywhere in Great Britain supposed to be more than a third part of the whole produce. If the land, which in one state of cultivation affords a rent of ten millions sterling a year, would in another afford a rent of twenty millions (the rent being, in both cases, supposed a third part of the produce), the revenue of the proprietors would be less than it otherwise might be by ten millions a year only; but the revenue of the great body of the people would be less than it otherwise might be by thirty millions a year, deducting only what would be necessary for seed. The population of the country would be less by the number of people which thirty millions a year, deducting always the seed, could maintain, according to the particular mode of living and expense which might take place in the different ranks of men among whom the remainder was distributed.

Though there is not at present, in Europe, any civilized state of any kind which derives the greater part of its public revenue from the rent of the lands which are the property of the state; yet, in all the great monarchies of Europe, there are still many large tracts of land which belong to the crown. They are generally forest; and sometimes forest where, after traveling several miles, you will scarce find a single tree; a mere waste and loss of country in respect both of produce and population. In every great monarchy of Europe the sale of the crown lands would produce a very large sum of money, which, if applied to the payment of the public debts, would deliver from mortgage

a much greater revenue than any which those lands have ever afforded to the crown. In countries where lands, improved and cultivated very highly, and yielding at the time of sale as great a rent as can easily be got from them, commonly sell at thirty years' purchase, the unimproved, uncultivated, and low-rented crown lands, might well be expected to sell at forty, fifty, or sixty years' purchase. The crown might immediately enjoy the revenue which this great price would redeem from mortgage. In the course of a few years it would probably enjoy another revenue. When the crown lands had become private property, they would, in the course of a few years, become well-improved and well-cultivated. The increase of their produce would increase the population of the country, by augmenting the revenue and consumption of the people. But the revenue which the crown derives from the duties of the customs and excise, would necessarily increase with the revenue and consumption of the people.

The revenue which, in any civilized monarchy, the crown derives from the crown lands, though it appears to cost nothing to individuals, in reality costs more to the society than perhaps any other equal revenue which the crown enjoys. It would, in all cases, be for the interest of the society to replace this revenue to the crown by some other equal revenue, and to divide the lands among the people, which could not well be done better, perhaps, than by exposing them to public sale.

Lands, for the purpose of pleasure and magnificence, parks, gardens, public walks, etc., possessions which are everywhere considered as causes of expense, not as sources of revenue, seem to be the only lands which, in a great and civilized monarchy, ought to belong to the crown.

Public stock and public lands, therefore, the two sources of revenue which may peculiarly belong to the sovereign or commonwealth, being both improper and insufficient funds for defraying the necessary expense of any great and civilized state, it remains that this expense must, the greater part of it, be defrayed by taxes of one kind or another; the people contributing a part of their own private revenue in order to make up a public revenue to the sovereign or commonwealth.[1]

[1] Smith's discussion of taxation will be considered in a later chapter. — ED.

CHAPTER V

REVENUES FROM DOMAINS

13. Later Views concerning Domains : Rau. — In England and France, where revenues from landed domains had already sunk to small proportions, the opinions of Adam Smith concerning public landholding gained instant acceptance, and have ever since dominated financial thought. In Germany, Smith's views were accepted by many writers during the first half of the nineteenth century, but after that German opinion gradually drifted back toward the older position, and became more favorable to the retention of domains. About the middle of the nineteenth century a leading economist, Karl Heinrich Rau, presented the following summary,[1] which has become classical in German science, of the reasons for and against the alienation of domains:

At the present day the following are the principal reasons in favor of the alienation of domains:

1. A government is not well fitted to carry on an industry. Private owners, as a rule, make better use of a source of income because they work with greater zeal, give more thought to the improvement of processes, and can manage any branch of industry with vigor, a thing especially important in intensive agriculture. Governments, on the other hand, must maintain an expensive body of lower and higher officials who are less energetic and economical than a proprietor, or are fettered by troublesome administrative regulations. Experience shows conclusively that domains in private hands yield a larger net income. . . .

2. The sale of domains is an easy method of paying off public

[1] From Rau's Finanzwissenschaft, §§ 94–98 (fifth edition, 1864).

debts, if it is considered important to do this on a large scale; while the treasury profits thereby because the purchase price of land is usually so large that the interest on the debt retired exceeds the former income from the domains.[1]

3. The possession of domains gives the government special interests of its own which make it disinclined to undertake many reforms of general benefit to society, such as the abolition of feudal burdens on landed property; or it may at least be unpopular on account of the conflict which arises with the interests of private citizens.

4. Experience shows that domains are in no way necessary to insure a revenue sufficient to meet public expenditure, and that in several states of western Europe in which the domains yield only a small amount, adequate revenue flows regularly into the treasury without pressing too heavily upon the citizens.

Upon the other hand, the retention of domains, even at the present day, may be defended upon other grounds:

1. From the standpoint of general statecraft, domains have been considered an important support of hereditary monarchy, which has sprung from the possession of large landed wealth and must always rest upon it. Income from domains is prized also because it does not depend upon the consent or grant of a parliamentary body, and can be relied upon in times of internal disturbance or social changes. . . .

2. The income from domains arouses no dissatisfaction or feeling of deprivation, because it flows from a business undertaking independently carried on by the government by means of public property which has long been withdrawn from private ownership. Upon the other hand, taxes have to be paid year after year from the incomes of private citizens, and unavoidably lead to many inequalities and much vexation. If the domains should be sold to poor advantage or the purchase money unwisely used, it would then be necessary even to increase the taxes in order to make good the loss of the income from the domains.

[1] If, for instance, domains which yield a net income of 1,000,000 florins can be sold for 30,000,000 florins, and this sum can be used in retiring debts which bear 4½ per cent interest, the government in this way saves 1,350,000 florins in interest payments, which exceeds by 350,000 florins the income formerly drawn from domains.

But with this argument it is necessary to observe that the alleged advantage of income from domains would not be decisive if the public lands were less productive than private estates so that the production of wealth would be smaller. Only when the domains are as well managed as private estates is this argument important. Then in the next place, if the money received in the sale of domains is applied to the extinction of debts or profitably invested, no increase of taxation would be necessary; while if other causes increase public expenditures, the retention of domains could not prevent heavier taxation. In a well-governed state legal precautions would be taken against squandering the money received from the sale of domains, or spending it for current outlays.

3. Even if experience shows that public lands in many cases yield a smaller income than private estates, it cannot be affirmed that this must invariably be the case. In this matter one must take into account the kind of land in question, and its quality; while it must be remembered that the methods of administering it may be improved. . . .

4. The income from domains must increase in the course of time, because the rent of land rises as the prices of its products advance and the soil is better and more scientifically cultivated. (Rau goes on to show that this consideration is offset by the fact that the income from the lands is larger under private management, and that the public treasury will profit, therefore, because the citizens are richer.)

5. Public loans can be more easily floated because the domains afford collateral security acceptable to creditors. This, however, is of little moment, especially in the larger countries with good credit, where well-managed finances and the proven good faith of the government make landed possessions unnecessary as a support for public credit. The concurrence of a parliament in contracting a loan is of greater aid to the public credit than the pledging of domains, a security which is sometimes of doubtful legal force.

6. Domains may be useful because improved methods of cultivation can be introduced upon them, and then the knowledge of such things can be widely extended. . . .

Later German writers generally attach less weight than Rau did to the arguments in favor of alienation. Wagner, for instance, says that Rau erred in giving attention exclusively to the financial aspects of the question, or to the influence of public landownership on the production of wealth, and says that the problem of the distribution of wealth and various questions of social policy should be taken into account. The retention of domains, he thinks, may be defended on such grounds even when the considerations mentioned by Rau seem to tell against it.[1] Into this subject we cannot follow him, since the questions involved are not of a financial character and fall outside of the scope of our studies.

14. The Public Domain of the United States. — By cession from the original states and by subsequent acquisitions of new territory (as in 1803, 1819, 1845, 1846, 1853, and 1867), the United States has, at various times, come into the proprietorship of a public domain of not less than 2,708,388 square miles. The general policy of the government has been to dispose of the land as fast as seemed practicable and desirable. The methods followed and results achieved are described in the following article by Professor Albert Bushnell Hart:[2]

First in amount and importance are the sales. The history of the public lands happens to fall into five tolerably distinct periods, each of about twenty years. From 1784 to 1801, the policy of the government was to sell lands in large quantities by special contract; the result was an average sale of less than one hundred thousand acres yearly. In 1800 was inaugurated a new system of sales, in small lots, on credit; about eighteen millions of acres were thus taken, but more than two and a half millions subsequently reverted to the government under relief acts. In the middle of 1820 began a system of sales for cash,

[1] Finanzwissenschaft, I, §§ 210–220.

[2] Reprinted, by permission of author and publisher, from Hart's Practical Essays on American Government, pp. 239 *et seq.* New York, Longmans, Green, and Co. (1893).

in lots to suit purchasers. Seventy-six million acres were sold in twenty years; but of this large quantity one half passed out of the hands of the government in the two years preceding the panic of 1837. After that revulsion, the preëmption system was adopted, by which the most desirable lands were reserved for actual settlers, at a low price. Except in the years 1856–57, the sales were steady, and kept pace with the growth of the West. The homestead system carried the principle of "land for the landless" still further, and cut down cash sales to an average of a million acres a year. Since 1880, preëmptions have been resorted to again, in many cases for fraudulent purposes; and the total sales average almost four million acres a year. At present, lands are classified by the land office as agricultural, saline, town site, mineral, coal, stone, and timber, and desert lands. From 1854 to 1862, there was a further class of "graduated lands." These were tracts which had long remained unsold, and were offered to abutters at very low prices. The mimimum price for ordinary lands has for many years been $1.25 per acre. Timber lands and lands reserved from railroad land grants are sold at the "double minimum" of $2.50 per acre; mineral lands are valued at $2.50 and $5.00 an acre; coal lands, at $10 and $20 an acre.

It would seem, therefore, as though the sale of a hundred and ninety-two million acres must have brought in a handsome sum to the government. As long ago as 1787, Thomas Jefferson wrote: "I am very much pleased that our Western lands sell so successfully. I turn to this precious resource as that which will, in every event, liberate us from our domestic debt, and perhaps, too, from our foreign one." It is true that the proceeds of the public lands did eventually wipe out the last vestiges of the debt which had existed in 1787. It is true that the lands had, up to June 30, 1883, brought into the Treasury of the United States the smart amount of $233,000,000. It is equally true that, except for the period from 1830 to 1840, the lands have been a drain upon our finances. At the end of the financial year 1882–83, the government was out of pocket, so far as cash outlay and receipts are measures of the value of the lands, in the sum of more than one hundred and twenty-six millions of dollars.

The first great item of expense is the extinguishment of the Indian claim to ownership. Since 1781, the United States government has recognized the right of occupancy, but has asserted its sole prerogative to acquire Indian lands. First and last, up to the end of the fiscal year 1882–83, it had paid two hundred and nine millions of dollars for the interest of the Indian in his lands. . . . A second source of expense has been the purchase money paid for all the annexations since 1802, except that of Oregon. The items in the category taken together make an outlay of upward of eighty-eight millions. Surveys and expenses of disposition add fifty-five millions. If a strict account were to be made up, there should be added to the expenditure a proportion of the general expenses of maintaining the government and the whole cost of the Mexican war.

Unsatisfactory as is the financial result of our public-land policy, we must reflect that the sales account for but little more than a fourth part of the total disposition. Perhaps we shall find the remainder so used as to give some indirect benefit which cannot be reckoned in dollars and cents. . . . (After describing early grants to soldiers and others, the author passes on to consider the homestead grants. — Ed.)

The homestead act of 1862 introduced a new principle into the public-land system; it provided not only for the reservation of farms for actual settlers, but it proposed to give land to all heads of families, citizens of the United States or intending to become such. The effect of the act has been threefold. Under its provisions and those of the similar timber-culture act of 1873, immigration has been stimulated, the revenue from the lands was for many years almost cut off, and one hundred and fifty millions of acres have passed from the public domain into private hands. In some respects, the rapid settlement of the West, which has been greatly favored by the generous policy of the government, has undoubtedly conduced to the welfare of the country, and has made possible our elaborate systems of transportation and distribution on a large scale. It is, nevertheless, a question whether the present generation, as well as posterity, might not have been equally prosperous, if the government had made the conditions of acquirement more rigorous.

To ascribe the depletion of our reserves of land to the bounty

and homestead acts is unjust; the United States has given to the states almost as much as to individuals. Most of the original sixteen states (including Vermont, Kentucky, and Tennessee) were in possession of unoccupied lands in 1802. The new states as they have been admitted have received large gifts of three kinds. To most of them have been granted from one to six townships of saline lands, an aggregate of half a million acres. For all admitted to the Union previous to 1850 have been reserved one thirty-sixth of the public domain within their limits, for school purposes. The fortunate states which have come in since 1850 receive one eighteenth, and a like amount is reserved in each of the territories, except the Indian Territory and Alaska. The total thus set aside is about sixty-eight million acres. For each of the new states and territories has also been reserved a tract of from two to four townships for a university — a total of more than a million acres. In 1862, Congress granted to each state in the Union lands proportioned to its representation in Congress for an agricultural college. Nearly ten million acres were thus appropriated. It is at least doubtful whether a system of endowed public schools is desirable. Many of the states have squandered, lost, or misused the lands acquired for educational purposes. In others the people decline to tax themselves for school purposes, and rely wholly on the fund. But it is even worse with other forms of grants to states. In 1841, a time of reckless disposition of the lands, a grant of five hundred thousand acres was made to each of seventeen of the states, for internal improvements. The largest single gift made to the states up to that time was included in the swampland grants of 1849 and subsequent years. All the "swamp and overflowed lands" within the limits of any state were granted to that state. It was expected that the sale of a part would pay the expense of reclaiming the whole. It does not appear that any great improvements have been made by the states; and the United States is now spending large sums in building levees to protect regions thus presented to the states in 1850. When the six new states were admitted into the Union in 1890 and 1891, they received the most magnificent endowment ever bestowed on republican commonwealths. Part of the area was reserved school lands; part of it was in

the form of new gifts for public buildings, universities, and other purposes; the whole amounted to twenty-three million acres, and the gift was accompanied by a promise that no part should be sold at less than $10 an acre.

Throughout the history of the country there has prevailed the double error that a gift of land cost the government nothing, yet was of very great value to the recipient. Upon the land that is of any worth, the United States has spent money for surveys and administration; yet the states and other grantees have found it hard to turn the gifts into money. A great part of the educational grants have realized not more than a dollar an acre. It would in many respects be preferable for the government to appropriate the proceeds of the lands rather than to give the disposal of the soil to the states. A distribution act was passed in 1841, by which the net amount received for public lands was to be paid to the states; but it was repealed so speedily that only about $700,000 was thus distributed. A much larger sum has accumulated, and has been paid to the states, under the "two, three, and five per cent funds." By agreement with each state as it has entered the Union, the United States consents to pay over a proportion of the net proceeds of the lands within that state. More than $7,000,000 have been allowed under this provision. The deduction is not strictly a gift, since the states in return bind themselves not to tax public land until it has been five years in the hands of a private owner.

In theory, the lands appropriated for internal improvements of various kinds have also been sacrificed in order to make the remainder more valuable. The Ohio five per cent fund in 1802 was intended to be applied to the construction of the Cumberland road, which was to be the great avenue for purchasers and settlers from the Atlantic coast. This was the beginning of the system of internal improvement at the expense of the nation; but, in practice, Congress built the road out of general funds. It was not until 1827, four years after the first river and harbor bill, that direct grants of lands were made in aid of internal improvements. The new and momentous policy began with grants for canals. Between 1827 and 1850 about three million acres had been appropriated to this purpose, principally to secure the

completion of the system connecting the lakes with the Ohio and Mississippi. The jealousy caused by the action of Congress brought about the comprehensive grant of five hundred thousand acres to each "public land state," to which reference has already been made. But the most familiar form of grants for internal improvements dates from 1850. By that year the railroad system had been extended so far west as to penetrate large tracts of unsold lands. Congress aided the extension of the system by assigning to the states of Illinois, Alabama, and Mississippi nearly four million acres, to be used toward the construction of the Illinois Central and Mobile and Ohio lines, reaching from Chicago to the Gulf. Between 1850 and 1872 about eighty similar landgrants were made. The principal lines of communication in Minnesota and Iowa, and important roads in Wisconsin, Illinois, Missouri, Arkansas, Louisiana, Alabama, Mississippi, and Florida, were subsidized. In 1862 a new problem presented itself. It became a political necessity to lay a line of railroad across the continent. Between Iowa and California there were no states to which the grant could pass. Congress, therefore, promised a subsidy of land to corporations which undertook to build the Pacific railroads.

In the ten years following, some twenty-three similar grants were made, in almost all cases for roads running east and west, and intended to form links in transcontinental lines. To satisfy the terms of the acts, about one hundred and fifty-five millions of acres would be necessary. Several companies never built their roads, and earned no grant; others completed the work after the prescribed time. In a few cases Congress has formally declared the grant void, and has restored the land to the public domain. A few grants for canals and for wagon roads, between the years 1863 and 1872, make up the three remaining millions of the grand total promised by the government — a total of a hundred and sixty-two millions of acres. Out of this amount only about fifty millions of acres had been patented to the states and companies in 1883. During the ten years following, there have been legal reversions to the government of fifty million acres out of unpatented landgrants; and large tracts are still disputed.

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Yet so vast is the area of the country that the government might repeat its sales and gratuities, acre for acre, without exhausting its reserves of land in the West alone. In spite of the fact that the states had in the beginning, or have retained, five hundred million acres, and that the United States has parted with seven hundred and thirty million acres, the public domain still comprises nearly a thousand million acres.[1] The real significance of the present alarm about the disappearance of the public lands, lies in the fact that the greater part of the unsold lands are either reserved for the Indians or are unfit for ordinary tillage. Upon the best vacant lands — amounting to about a hundred millions of acres — the Indians are still seated. The area can be reduced by judicious and costly treaties; but it amounts only to about three hundred acres per head; and, if the occupants should take up land in severalty to the amount of 320 acres for each head of a family, they would still retain thirty million acres of valuable lands; they could not be dispossessed without such injustice as would rouse the nation. Experts in the land office assure us that, making all deductions and all allowances, the remaining lands are worth upward of a thousand millions of dollars. There is no evidence in the past policy of the government for believing that we shall actually net one tenth of that amount. The greater part of the region is officially classified as "Desert Lands," and is for sale in tracts of 640 acres, at $1.25 an acre. Nothing but the temporary increase of preëmption has enabled the land office at present to pay its running expenses out of its income. The golden time is past; our agricultural land is gone; our timber lands are fast going; our coal and mineral lands will be snapped up as fast as they prove valuable. There is no great national reserve left in the public lands unless there should be a change of policy. Should disaster overtake us, we must depend, like other nations, on the wealth of the people, and not on that of the government.

It is, of course, true that the lands are still in existence, and have been made many times more valuable by the labor of the

[1] On July 1, 1903, the unappropriated and unreserved public lands amounted to 841,872,000 acres, and the reserved lands to 172,873,000 acres. The lands sold or given away aggregated 791,[illegible] acres. — Ed.

occupants. It is further true that large quantities of vacant land are for sale by the railroads and other grantees. There is no immediate danger of a land famine. There is abundant cause for criticism of the system adopted by the United States, but it should rightfully be directed rather against the manner in which the laws have worked than against their purpose. Since 1841 the lands have nominally been reserved for actual settlers; but practice has shown grave defects in the settlement laws — defects which Congress has no will to remedy. No man can legally preëmpt land or take up a homestead more than once; but this limitation is very difficult to guard, and perjury and fraud are alarmingly frequent. No one man can legally acquire more than 1120 acres of land from the government, if any one else wants the land; 160 acres as a preëmption, as much more as a homestead, another quarter section as a tree claim, and a section of 640 acres as a desert-land claim. Actually, single individuals and companies own large estates, which a few years ago were in the hands of the government.

The accumulation of the large tracts is often brought about by fraud, but much oftener through the mistaken generosity of the government or through defective land laws. It is not always necessary to hire men fraudulently to take up land for the company. In Texas, the state has sold its lands in its own way, often in large blocks. The school lands and the scrip for bounty warrants have legally been used for locating wide extending estates. The railroad lands, although not in compact tracts, can be used as a nucleus for a large accumulation; and, in a country where land is cheap and money dear, the patient, long-headed capitalist can buy up valuable claims in a legitimate manner. The chief source of the present trouble in the West lies in the fact that the government never recognized that grazing land must be sold and occupied under different conditions from ordinary arable lands. The first comers have been allowed to take up the water fronts. Any comprehensive system of irrigation of large areas for the benefit of future land seekers has thus been forever prevented. The possessor of the rivers and water-holes has gained control of the country behind his claim. In such a contest, the largest and richest concerns have a great advantage. There was a time when the government

might have laid out, for sale or lease, large tracts of grazing lands, each with a sufficient water front. It is now too late.

The fundamental criticism upon our public-land policy is, not that we have sold our lands cheap, not that we have freely given them away, but that the gifts have in too many cases inured to the benefit of those whom the government meant to ignore. The "land grabber" is, in most cases, simply taking advantage of the chances which a defective system has cast in the way of shrewd and forehanded or unscrupulous men. The difficulty is certainly not in the land office, which, in the midst of perplexing complications, has striven hard to protect our lands. The fault lies at the door of the Congress of the United States, which has the power, but not the will, to correct notorious defects in our system. Still farther back, the fault is with the free citizens of the Republic, who have been too much occupied to insist that there should be a comprehensive land policy, providing for the equitable disposition of all classes of the public lands.

15. The Case of Forests. — It is now generally admitted that public ownership of forests stands upon a very different footing from public ownership of agricultural land. Leroy-Beaulieu, for instance, who supports strongly the view that public ownership of agricultural domains is unwise, holds that the case is otherwise with forests. He says:[1]

Up to this point we have studied only the agricultural domain of the state, but the greater part of the land owned by states consists of forests. These differ very greatly from agricultural holdings. They are much better adapted for state management because they have to be administered on a large scale, methodically, and by scientific rules. The ability of the state to manage forests is better established than its ability to administer agricultural properties. In the former case the state seems to have the natural mission to preserve this form of wealth, which is so necessary to the country and so likely to be destroyed by private individuals. The state, since it is in

[1] Traité de la science des finances, Pt. I, Bk. 1, ch. 4. Reproduced by permission of the author.

modern societies the only immutable thing, the only agent to represent posterity and to guard the interests of coming generations, does not depart from its legislative functions when it preserves forest property the maintenance of which is considered advantageous to the prosperity of the country.

At this point we should not take the purely financial, what the Germans call the "cameral," point of view. Although forests may be a source of revenue to a state, and, as we shall show, a source of increasing revenue, this is merely an incidental consideration; it would not be enough to justify state ownership of forests. And it is no longer necessary to consider the question from the administrative point of view, with reference to the needs of the public service. Formerly one of the reasons assigned for state forest preservation was that the navy needed the most perfect ship timber, which could with difficulty be found in private forests. But now that ships are built chiefly of iron and steel, this argument has lost its force. In truth it never had much weight, since a state could always purchase abroad, by offering a suitable price, the ship timber which it needed. And, finally, the subject should not be studied from what may be called the "democratic" point of view. Sometimes state preservation of forests has been urged in the interests of the consumers, especially of the lower classes, to whom wood is an article of prime necessity, the price of which ought not to be too high. But the state is no more bound to insure to consumers a reasonable price for wood than for grain; and, besides, it could be argued that while the state reduced the price of wood by preserving a large forest area, it was raising the prices of grain and meat by reducing the area devoted to producing these commodities.

The true point of view is that of the influence of the forests upon the climate, the flow of rivers, and the general conditions of production. If it is demonstrated that the complete disappearance or the serious diminution of the forests results in more frequent drouths and turns rivers into devastating torrents, it is evident that the important interest of the regulation of the water supply justifies state ownership of forests. The disappearance of these forest reserves, which regulate naturally the flow of the rivers, would injure the surrounding country,

deprive it of part of its productivity, and decrease its salubrity. Now these facts have been established conclusively. . . . They have been observed in France, particularly in Provence, in Algiers, in various European countries, such as Austria and Italy, and in America also, especially in Brazil.

Experience proves that private owners generally are very much inclined to cut trees, and very little inclined to plant them, at least in large quantities. Forest destruction offers the allurement, often deceptive, of great increase in the value of the land when it is transformed into open fields; and a great number of landowners are seduced by this prospect, especially peasants. Upon the other hand, tree planting and sowing upon a large scale, since they entail an immediate expense which will yield no return until the end of a long period of years, are undertaken only by men of foresight and of easy circumstances.[1]

16. National Forest Reserves in the United States. — The conditions just described have led the United States to establish national forest reserves of which the following brief account has been published by the Forest Service:[2]

Forest reserves are for the purpose of preserving a perpetual supply of timber for home industries, preventing destruction of the forest cover which regulates the flow of streams, and protecting local residents from unfair competition in the use of forest and range. They are patrolled and protected, at government expense, for the benefit of the community and the home builder.

[1] At the present day the forest area of the German Empire is about 13,956,000 hectares. Of this 33.3 per cent belongs to the royal or state forests and 15.6 to various local governing bodies. Private owners, individuals, or associations hold 51.1 per cent. Elster, Wörterbuch der Volkswirthschaft, I, 737. In France the forest holdings of the central government amount to about 1,070,000 hectares, and those of the communes amount to about 2,058,000 hectares. Bastable, Public Finance, 171. From a financial point of view, income from forests is generally not important, except in some of the German states. The Prussian budget for 1903 estimated the gross receipts from forests at 106,854,000 marks, and the net receipts at 60,000,000 marks. Bastable, 172. — Ed.

[2] The Use of National Forest Reserves, 7-11. Published by the Forest Service (1905).

We know that the welfare of every community is dependent upon a cheap and plentiful supply of timber; that a forest cover is the most effective means of maintaining a regular stream flow for irrigation and other useful purposes; and that the permanence of the live-stock industry depends upon the conservative use of the range. The injury to all persons and industries which results from the destruction of forests by fire and careless use is a matter of history in older countries, and has long been the cause of anxiety and loss in the United States. The protection of the forest resources still existing is a matter of urgent local and national importance. This is shown by the exhaustion and removal of lumbering centers, often leaving behind desolation and depression in business; the vast public and private losses through unnecessary forest fires; the increasing use of lumber per capita by a still more rapidly increasing population; the decrease in the summer flow of streams just as they become indispensable to manufacture or irrigation; and the serious decrease in the carrying capacity of the summer range. It cannot be doubted that, as President Roosevelt has said, "the forest problem is, in many ways, the most vital internal problem of the United States."

As early as 1799 Congress provided for the purchase of timber lands to supply the needs of the navy, and in 1817 further legislation directed the setting apart of public lands for the same purpose, and provided penalties for the unauthorized cutting of any public timber. Other acts, from time to time, made similar provisions for setting apart forest land for specific purposes, but the first attempt to secure a comprehensive administration of the forests on the public domain was in 1871, by a bill introduced in the Forty-second Congress, which failed of passage.

In 1876, $2,000 was appropriated to employ a competent man to investigate timber conditions in the United States, and on June 30, 1886, an act was approved creating a Division of Forestry in the Department of Agriculture. On July 1, 1901, this division became the Bureau of Forestry (now the Forest Service), employing practically all the trained foresters in the United States, and engaged in almost every branch of forest work in every state and territory, except the actual administration of the government forest lands. These remained in the Department of the

Interior, which, although possessing complete machinery for the disposal of lands, was provided with neither system nor trained men for conservative forest management.

In the meantime, with the increasing realization that the nation's timber supply must be protected, and with the immense growth of irrigation interests in the West, the necessity for retaining permanent federal control over selected forest areas was recognized by a brief section inserted in the act of March 3, 1891, which authorized the President to establish forest reserves. The first exercise of this power was in the creation of the Yellowstone Park Timber Land Reserve, proclaimed by President Harrison March 30, 1891.

The mere creation of forest reserves, however, without provision for their administration, was both ineffectual and annoying to local interests dependent upon their resources. Consequently the Secretary of the Interior, 1896, requested the National Academy of Sciences to recommend a national forest policy. This resulted in the passage of the act of June 4, 1897, under which, with several subsequent amendments, forest reserves are now administered.

On the theory that the management of land, not of forests, was chiefly involved, this law gave the Secretary of the Interior authority over the reserves, and provided that their surveying, mapping, and general classification should be done by the United States Geological Survey, and the execution of administrative work by the General Land Office.

The result was not satisfactory. The technical and complex problems arising from the necessary use of forest and range soon demanded the introduction of scientific methods and a technically trained force, which could not be provided under the existing system. The advice and services of the Bureau of Forestry were found necessary, but, under the law, could be but imperfectly utilized. The necessity of consolidating the various branches of government forest work became apparent and was urged upon Congress by the President and all the executive officers concerned. Finally, the act of February 1, 1905, transferred to the Secretary of Agriculture entire jurisdiction over the forest reserves except in matters of surveying and passage of title.

The regulations and instructions for the use of the national forest reserves here published are in accordance with the act last mentioned and with that of March 3, 1905, making appropriations for the Department of Agriculture, which changed the Bureau of Forestry into the Forest Service. They are based upon the following general policy laid down for the Forest Service by the Secretary of Agriculture in his letter of February 1, 1905, to the forester:

"In the administration of the forest reserves it must be clearly borne in mind that all land is to be devoted to its most productive use for the permanent good of the whole people, and not for the temporary benefit of individuals or companies. All the resources of forest reserves are for *use*, and this use must be brought about in a thoroughly prompt and businesslike manner, under such restrictions only as will insure the permanence of these resources. The vital importance of forest reserves to the great industries of the Western states will be largely increased in the near future by the continued steady advance in settlement and development. The permanence of the resources of the reserves is therefore indispensable to continued prosperity, and the policy of this department for their protection and use will invariably be guided by this fact, always bearing in mind that the *conservative use* of these resources in no way conflicts with their permanent value.

"You will see to it that the water, wood, and forage of the reserves are conserved and wisely used for the benefit of the home builder first of all, upon whom depends the best permanent use of lands and resources alike. The continued prosperity of the agricultural, lumbering, mining, and live-stock interests is directly dependent upon a permanent and accessible supply of water, wood, and forage, as well as upon the present and future use of these resources under businesslike regulations, enforced with promptness, effectiveness, and common sense. In the management of each reserve local questions will be decided upon local grounds; the dominant industry will be considered first, but with as little restriction to minor industries as may be possible; sudden changes in industrial conditions will be avoided by gradual adjustment after due notice, and where conflicting interests must be reconciled, the question will always be decided from

the standpoint of the greatest good of the greatest number in the long run."[1]

17. The Land Policy of the American States. — Our various states have owned considerable land, and have usually followed the general policy of selling it as fast as possible. Recently, however, there have been some indications of a more conservative policy. These are described by Professor W. M. Daniels as follows:[2]

The earlier tendency of the Western states to cut up the public domain and to encourage the creation of homesteads by the sale of farms in fee simple, while it continues generally (though under various safeguards against land speculation and monopoly), has in a measure been checked by several causes. Chief among them may be mentioned the increasing use of public lands for mining, specially coal mining, and also the necessity of securing irrigation in various arid sections. Even the further alienation of the public domain when the land is to be used for farm purposes has in several instances been brought into question.

Colorado, for example [1903, ch. 151], has created the office of Superintendent of the Mineral Department of the State

[1] On August 1, 1905, the national forest reserves were as follows:

Arizona	7,242,170	acres
California	15,551,128	"
Colorado	11,670,923	"
Idaho	9,488,324	"
Kansas, Nebraska, and Oklahoma	363,302	"
Montana	8,134,960	"
New Mexico	3,754,780	"
Oregon	6,072,550	"
South Dakota	1,263,880	"
Utah	4,178,960	"
Washington	7,785,600	"
Wyoming	8,197,799	"
Total	83,704,376	"
Alaska	4,909,880	"
Porto Rico	65,950	"
Grand Total	88,680,206	"

— ED.

[2] New York State Library, Review of Legislation for 1903. State Finance,

Board of Land Commissioners, whose duty it is to measure the space excavated from all coal mines leased from the state and report thereon, to the end that the state shall receive its royalty of ten cents a ton on all coal mined. The same act also provides that "agricultural lands and lands within city boundaries may be leased for a term not exceeding thirty years," and that "all such leased land shall be reappraised and classified at least every five years, and the lessee of all such lands shall pay any increased rental or forfeit the lands so held."

Wyoming [1903, ch. 78] empowers the State Board of School Land Commissioners and the State Board of Land Commissioners to lease and release public lands on certain terms prescribed in the act. This does not, however, prevent them from selling state lands, the act in question giving them "the direction, control, lease and disposal of all lands" intrusted to their respective charges. Wyoming also [1903, ch. 85] opens its mining lands to exploration, occupation, and purchase, and defines the size of a mining claim. North Dakota [1903, ch. 176] provides for the lease of school lands for the purpose of coal mining. A similar act providing for the sale or lease of state lands was passed by Washington [1903, ch. 79]. Typical of the legislation relating to arid lands and their reclamation are those passed by New Mexico [1903, ch. 78] and Washington [1903, ch. 152]. The former provides for the selection and segregation of lands donated by Congress for institutional and irrigation purposes.. Lands belonging to institutions, except those of the university, are to be sold at an early date in order to reimburse the territory for cash advanced to said institutions, and the excess of the price is to be turned over to the institutions in question. By the same act all leases of lands donated by Congress for the improvement of the Rio Grande are to be canceled, except such as the Secretary of the Interior has approved or may approve; also all leases of lands donated by the federal government for irrigation or reservoir purposes are to be terminated, and no such leases granted in future. The act of Washington [1903, ch. 152] provides for the acceptance from the United States of arid lands, and specifies the terms on which individuals or companies may contract with the state to irrigate said lands. Settlers or proposing settlers who show contracts

made with an approved irrigation company for perpetual water rights may on payment of the price named file entry claims for 160 acres each.

Tide, shore, and swamp lands. — California, New Jersey, and Pennsylvania have amended their laws as to tide, shore, and swamp lands. California [1903, ch. 61] aims to prevent fraud in reclaiming land for farm purposes; New Jersey [1903, ch. 202] to limit the use of tidelands to public parks, streets, or highways under the control of the municipalities; Pennsylvania [1903, ch. 28] to prevent individuals from securing the beds of navigable streams.

Timber lands. — Michigan has passed a series of laws for the protection of timber on state lands. One act [1903, ch. 145] provides for the seizure, marking, and sale of state timber unlawfully cut. Another act [1903, ch. 210] makes it a felony instead of a misdemeanor to remove or injure timber on state lands. A third act [1903, ch 226] directs the State Commissioner of the State Land Office to appoint trespass agents to look after timber interests on state lands. Tennessee [1903, ch. 444] has made the unlawful cutting of timber on state lands a felony, and New Mexico [1903, ch. 81] has made it a misdemeanor with each day's violation a separate offense.

CHAPTER VI

REVENUES FROM PUBLIC INDUSTRIES

18. The Post Office. — The best-established and in many cases the oldest form of public industry is the postal service, which Adam Smith described as "the only mercantile project which has been successfully managed . . . by every sort of government." The history and principles of administration of this branch of public business are thus discussed by President A. T. Hadley, of Yale University:[1]

I. History

The first extensively organized postal service was the *cursus publicus* of the Roman Empire. It was developed in connection with the system of Roman roads, and, like them, was primarily intended to subserve military and administrative purposes. It amounted to nothing more than a fully equipped set of relay stations for the rapid forwarding of official correspondence, not for the use of the general public. Traces of it survived the fall of the old Roman Empire, and lasted well on into the Middle Ages; but not as an institution with which modern postage can be shown to have any historical connection.

The postal systems which sprang up in the Middle Ages were, as might be expected, not centralized, but in the hands of local organizations: commercial cities, universities, or orders of knights. The city post offices were the earliest organized, and in the time of prosperity of the Hanseatic League attained a high stage of development. Originally intended for purposes of trade communication between the guilds and merchants of Westphalia and those on the sea coast, they became an im-

[1] Reprinted, by permission of the author and arrangement with the publishers, from Lalor's Cyclopædia of Political Science, III, 306–310. Published by Maynard, Merrill, and Company, New York (1883–84).

portant convenience to the general public of Northern Germany. The postal arrangements of the universities were developed in a similar way. First intended as a channel of communication between scholars and their homes, the same facilities were soon afforded to others who lived where they could avail themselves of them. The most important example of the third class was the postal service of the knights of the Teutonic order, extending over the northeast of Germany almost as widely as that of the Hanse towns over the northwest.

At the end of the fifteenth century, as centralizing governments grew up and supplanted the feudal system, national postal service was attempted, and ultimately prevailed. In this, as in all other similar matters, France took the lead. The first steps were taken by Louis XI, and they were followed up by Charles VIII. The wars of the sixteenth century checked this development; but it was resumed under Louis XIII; and in 1681 was so far advanced that letter carrying was made a government monopoly, though largely controlled by private hands till the legislation of 1790. In England there are traces of a postal service and postal regulations going back to a very early time; but the organized business of letter carrying seems to date from the reign of James I. It was made a government monopoly by the legislation of 1649 and 1657, although the business was farmed out until 1709.

In the countries ruled by the house of Austria, an international postal system was started under the administration of the Taxis family. At the beginning of the sixteenth century they established regular communication between Brussels and Vienna; soon a line was added to Milan and beyond, and not long after a further line to Madrid. In 1595 Leonard von Taxis received the office of postmaster general of the empire; and in 1615 this dignity was made hereditary. It was much harder to establish a monopoly here than in France or England, owing to the extent of ground to be covered, the full development of special postal services, and the weakness of the imperial authority. The nominal rights granted by the investiture could only be carried into effect by treaties with the individual states; and many of these preferred to maintain postal systems of their own. This was the case in Austria on the one hand, and in

Brandenburg (and thus eventually Prussia), as well as many less important states of North Germany, on the other. The postal service of the Taxis family was thus chiefly exercised in the smaller states of Middle and Southern Germany, where it survived the fall of the empire, and lasted till 1866.

A long time elapsed after the governments took control of the postal service before they made it efficient. The usefulness of the English post office dates from the year 1784, when measures of reform were introduced by Palmer, the postmaster general, with the warm support of Pitt. Previous to his time the mail conveyance had been infrequent, slow, irregular, and utterly unsafe. In the eight years of his tenure of office he doubled the frequency and speed of conveyance, and secured a reasonable degree of regularity and safety, chiefly by the substitution of coaches for single riders as a means of carriage. But, though the service was much improved, the rates continued exorbitant; so much so that a vast deal of private letter conveyance was done, in defiance of government rights. In the years 1830–35 the pressure in favor of low rates began to make itself felt; and the movement in this direction was ably headed by Rowland Hill, whose work on "Postal Reform, its Importance and Practicability" appeared in 1837. His proposal to reduce inland postage to about one tenth of its former figure was so sweeping as to cause a great sensation and not a little opposition; but the idea was carried out in 1840, and the example thus set by England was soon followed by the other civilized nations; though generally with gradual instead of sudden reduction.

The bill which established penny postage also introduced the use of postage stamps. The idea was not a new one; abortive attempts to carry it out had been made in France in 1653 and 1758, in Spain in 1716, in Sardinia in 1819–36. But in connection with the reduced postage and increased correspondence which followed it, stamps proved of indispensable service; and the example of England in introducing them was, within ten years, followed by nearly all prominent states. In the years 1869–74 came the still further reduction in price effected by the use of postal cards, originating in Austria.

The postal system of the United States dates from colonial times, being specially provided for in the postal act of Queen

Anne's reign; and its character was not very distinctly changed by the separation, or by any causes other than the natural growth of the country. Before the passage of the act of 1845, inland rates varied from six to twenty-five cents a sheet. The act of 1845 provided for rates of five and ten cents, according to distance; and in 1847 stamps of these denominations were introduced. In 1851 postage for nearly all home letters was reduced to three cents.[1]

The detailed history of postal development in different countries offers so few peculiarities that it is unnecessary to treat them separately. Everywhere we have, first, gradual improvement of service; then, simultaneously, lowering of rates, equalization for different distances, introduction of postage stamps, abandonment of the sheet as the unit of charge, and substitution of a unit of weight, at first almost always somewhat below the present half ounce (fifteen grams) standard. By the year 1851 the postal legislation and policy of civilized nations, as far as concerns home correspondence, had approached near to its present shape.

Not so with foreign correspondence. For a long time nothing was done to encourage that, even by those administrations that were anxious to extend home facilities. It was not until 1833 that a daily mail was established between London and Paris; and even then there was communication but twice a week with other parts of the continent. There were discriminating rates against foreign correspondence, which were sometimes almost prohibitory. The rate for a letter from London to Dover was *8d.*; but if it was to be forwarded to France, the charge for the same part of the route in 1834 was 1*s.* 2*d.*; if intended for Germany, 1*s.* 8*d.*; for Italy, 1*s.* 11*d.* The ship charge for carrying a letter to the United States was six cents, or 3*d.*; the rate charged by the British post office for delivering such a letter to the ship was 2*s.* 2*d.* For letters directed to Spain, it was the same; for those to Brazil the inland rate was actually 3*s.* 6*d.* The rates of other countries indicated a similar policy. As international correspondence increased, and with it the demand for more favorable terms, these high charges could not well be reduced without common action on the part of the two nations

[1] Upon October 1, 1883, the rate was reduced to two cents. — Ed.

concerned. Hence resulted a number of postal treaties, among which may be mentioned, as leading ones, the system of treaties (1840–50) between Austria, Prussia, and the smaller German states — many of the latter still represented by the heir of the Taxis family; also the series between France and England. Not the least important and delicate matter in some of these treaties was the provision concerning charges for letters in transit, to be delivered in some third country beyond. By means of these treaties the rates between the different nations of Europe were gradually reduced. Not so successful was the attempt to reduce them between Europe and America. The foreign postage policy of the United States had been for a long time exceedingly liberal, and it was only the conservatism of England that had prevented cheap postage between the two countries. Then at the time when England was making her postal reforms at home, steamships were taking the place of sailing vessels; and the subsidies which England wished to pay the steamship lines made her statesmen unwilling to reduce a postage rate which seemed to furnish such a suitable means of defraying the expense. Then came the adoption of the same system on the part of France, and attempts in the same direction in America; and every effort to support a subsidized steamship line lessened the strength of the demand for cheap transmarine postage. The United States rate for a considerable time was twenty cents, except where special arrangements provided otherwise; and these arrangements were apt to mean higher instead of lower rates. But with the abandonment of the Collins line of steamers, the United States again took strong ground in favor of lower rates; and, at its suggestion, a conference was held at Paris in 1863, relative to common action in the matter of international postage. This conference was only deliberative; it did not do away with the necessity of special treaties, though there was a continued lowering of rates in these. A similar conference, to be invested with greater powers, was invited to meet at Bern, in 1873; but as France, on the ground of financial embarrassments, declined to take part, it was postponed and reconvened in September, 1874, when the leading nations were satisfactorily represented. In spite of some moderate opposition from France, which was hampered by its subsidy system of mail contracts, and in spite

of great lukewarmness on the part of England, public feeling in favor of cheap postage was so strong that, on October 9, a postal union was formed on a general basis of five cents per half ounce letter postage, to go into effect, with some few exceptions, July 1, 1875. Even France agreed that it would ultimately acquiesce in this rate. Other nations, not at first included, joined the postal union in rapid succession, and in 1878 a second congress was held at Bern, which carried out the ideas of the first into the shape of a postal union treaty, embracing the following points: 1, harmonious arrangement of lines for international connection, transit, etc.; 2, avoidance of international competition; 3, proper distribution of expenses, and, if necessary, pooling of receipts; 4, international equality of treatment; 5, equality of standards of weight, etc. These postal treaties have now been agreed to by all Europe and most of the other countries of the world. The postal union has a permanent organization at Bern, with its regularly published series of reports.

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In this historical account, attention has been confined to the letter post as the most important part of the system. The post office has at different times and places attempted the conveyance of newspapers, unsealed packages, money, persons, and telegrams; not to speak of matters like postal savings banks, being quite aside from its main function. In almost all cases it has done so in more or less direct competition with private enterprise: though the English government had, up to the year 1840, a virtual monopoly of newspaper carriage; while in many parts of the continent of Europe the actual competition in forwarding small parcels is not to-day noticeable. The conveyance of money has generally been effected under a form like a registered letter; but in England the habitual use of cheques led to the early development (1838) of the post office money order, which was slow in making its way into other countries. The rapid conveyance of persons from place to place by government posting arrangements, was at one time almost as important, at least in the eyes of the authorities, as the conveyance of letters; but it, of course, nearly fell away with the introduction of railways, except in the few countries, like Norway, which combine considerable demand for communication with the impracticability

of railways. On the other hand, postal telegraphy seems destined to grow in importance. In many countries of Europe the telegraph was from the beginning developed in connection with the post office; while in England it was brought under its control in 1870.

II. Principles of Administration

The question whether the state should control the post office need not be seriously discussed as an open one. Our experience with railroads has shown what we may expect from private management in affairs of this kind — unsteadiness and discrimination of rates, and development of competing and favored points at the expense of all others. When it is impossible to avoid this in transportation, unless by combinations and monopolies no less dangerous than the evil itself, it can hardly be seriously proposed to introduce it into the system of postal communication. On the other hand, the question as to how far the post office should extend its activity to the conveyance of parcels, telegrams, etc., cannot be adequately treated here; partly because the necessity changes so entirely with varying local conditions, partly because special technical reasons are involved, to which justice can be done only in separate articles.

Setting these points aside, we have two distinct series of questions to deal with: first, as to the financial or administrative aims with which the post office should be conducted; second, as to the means to be employed for securing those aims. Of the two, the first is more difficult, and at the same time of more general importance and interest.

We see in the history of the institution that the post office was taken up by governments far more with a view of strengthening their own position than for the convenience of their subjects. This was equally the case whether they used it exclusively for their own business, as in Rome, or for the sake of getting administrative control into their hands, as in France. This carelessness of public interest led to its management under systems of lease or investiture, whatever means would secure money or influence with the least trouble. That state of things was outgrown in the last century, and men attained to the conception (though not always to the reality) of the postal service

as a public interest; to be managed directly by the state for the public advantage. But the particular form of public advantage to be aimed at was not yet settled. The post office might be managed in any one of four ways: 1, as a tax; 2, to yield good business profit; 3, to pay expenses; 4, to best accommodate the public. On the whole, the third of these principles is tending to prevail, but there has been, and is still, much deviation from it.

1. The use of the post office as a means of taxation was an idea belonging distinctly to the earlier period, now outgrown. Yet, in practice, the lowering of rates was so slow that the government monopoly at the charges ruling previous to 1840 had all the characteristics of a tax, and of one placed at the highest limit the business would bear; making itself felt not so much by the amount of money collected as by the means adopted to evade payment, by keeping correspondence within narrow limits or forwarding it by illegal agencies. The discriminating rates against foreign postage were still more obviously of the nature of a tax, and were felt to be so when connected with the subsidy system; so that the abandonment of the principle of managing the post office as a tax cannot be said to have been complete till the final lowering of rates by France and Italy subsequent to the postal congress of 1878.

2. The idea of managing the post office to obtain business profits is much more plausible, and in those branches of the postal service which come into competition with private agencies, such as express companies, is probably sound. But in letter carrying, where there is a government monopoly, it is liable to misapplication in two ways. First, the absence of competition leaves the decision as to what constitutes a good business profit in the hands of the post office authories, who, in the uncertain conditions and bases of calculation, have every motive to aim too high, and thus give the result the character of a tax; and, second, the absence of outside control of rates makes it natural for the authorities to secure the required excess of income over expenditure by doing a small business at high charges, instead of a large business at low charges. As a matter of fact, business profits under a government monopoly are not clearly distinguishable from taxes. Compare the arguments used (1835–50)

against lowering postal rates with the results which actually followed such lowering. The most marked instance of reduction and its consequences may be taken from Rowland Hill's reform, by which postage was reduced to one tenth its former figure. The financial showing did not quite realize Hill's anticipations, partly on account of a change in the legislation respecting newspapers; nevertheless, the department continued to do much more than pay expenses; its gross income reached its former figure in ten years, its net income in about thirty years; and in the last case the department was serving the public by carrying fourteen times as many letters as in 1839. The system of business profits is, however, in large measure maintained both in England and France.[1]

3. The idea of managing the post office simply to pay expenses gained hold in connection with the reforms of 1840. Even those writers who, from a financial standpoint, criticise the suddenness of Hill's change, and prefer the continental and American policy of gradual reduction, do so on account of the evils of suddenly shifting the burdens of taxation rather than from any objection to the principle itself. Yet, while their theorists hold this view, in practice most European states so far keep to the older policy as to secure a slight excess of income over expenditure in this department; perhaps, in general, not more than would meet interest on the cost of buildings. The disadvantages of the profits principle have been already set forth; the corresponding advantages of the cost principle are: first, that it takes away the uncertainty as to the result to be striven for; and, second, that it furnishes a tangible basis on which the rates are likely to be computed, with due regard to the public interest.

4. To carry letters without paying expenses (that is to say, below cost) is to tax the general public for the sake of a special service; usually a thing to be avoided. Yet, there are considerations which sometimes make it necessary to proceed on this principle. In countries like the United States or Russia, there

[1] In England, in 1904, the net revenue of the post office proper was £4,644,000; then after meeting a deficit in the department of telegraphs, the net revenue still stood at £3,660,000. In France, in 1902, the net revenue from posts and telegraph was 66,120,000 francs. — Ed.

are strong social and administrative reasons for establishing long routes over sparsely populated districts. These involve a large increase in expense, with no corresponding increase in revenue, whatever rate of postage is charged upon them. They have often caused a postal deficit in Russia, and almost always in the United States. If the expense of these routes causes a deficit in the whole department when the rates of postage are moderate, the additional income which could be obtained by higher postal rates would not be likely to cover it, because higher postal rates mean fewer letters. Thus the government must be prepared to meet the deficit. But — to take another consideration — suppose that the deficit could be met by higher rates. Suppose that in America by such rates a surplus could be obtained in the already self-sustaining East, sufficient to meet deficits in the South and West,[1] or that such surplus could be obtained upon the main routes as to meet deficits upon the minor ones. What then? Such a proceeding would be a tax upon the correspondence of one section for the benefit of another. The interests subserved by such routes are not the postal interests. They are the general interests of the country; and to force the postage returns of other sections to pay for this service is to intensify the unfairness of taxation which it is intended to avoid. Thus the principle now generally favored is, that the post office should aim to pay expenses; but the traditional practice of European administrations is to make it do somewhat more; and the special circumstances of the United States have justified the practice of allowing it to do somewhat less.[2]

How shall the rates be adjusted in accordance with the financial principle chosen? is the second question. Under the older systems of taxation or profit, the rate was carried as high as the business would bear, and often higher, with the result of caus-

[1] In a recent year the gross receipts of all post offices were $139,586,000. Of this sum, $10,000,000 was collected in Massachusetts and Connecticut; $41,300,000 in New York, New Jersey, Pennsylvania, and Maryland; $34,400,000 in Ohio, Indiana, Illinois, Michigan, and Wisconsin. These eleven states furnished $85,700,000, or about 61 per cent of the total post-office revenue. — Ed.

[2] In the United States the postal revenues uniformly exceeded the expenditures from 1789 to 1819; so that during that period the post office earned a profit of $1,642,000. From 1820 to 1852, there were thirteen years in which there was a surplus, and nineteen in which there was a deficit; the entire period of thirty-two

ing much smuggling. On those principles they of course charged much more for long routes than for short ones. Until 1845 the United States minimum charges were as follows: under 30 miles, 6 cents; under 80 miles, 10 cents; under 150 miles, $12\frac{1}{2}$ cents; under 400 miles, $18\frac{3}{4}$ cents; over 400 miles, 25 cents. Yet, even at this time, before the development of railways to any extent, it was computed that the cost of transmission of letters constituted less than two sevenths of the whole, and the cost of collection and delivery more than five

years showing a very slight deficit; so that practically revenue balanced expenditure. From 1852 to the present time there has generally been a deficit as shown by the following table of the money paid out of the United States Treasury to meet deficiencies in the postal revenues:

(In thousands of dollars)

1852	1,741	1879	3,297
1853	2,255	1880	3,597
1854	2,736	1881	3,297
1855	3,114	1882	6
1856	3,748	1883	21
1857	4,528	1884	140
1858	4,679	1885	6,066
1859	3,915	1886	8,751
1860	11,154	1887	4,746
1861	4,639	1888	3,386
1862	2,598	1889	5,745
1863	1,007	1890	6,100
1864	749	1891	4,441
1865	3	1892	6,260
1866	—	1893	6,727
1867	3,991	1894	10,200
1868	5,696	1895	9,872
1869	5,707	1896	8,830
1870	4,022	1897	12,133
1871	4,126	1898	9,341
1872	4,993	1899	7,902
1873	5,990	1900	6,250
1874	5,922	1901	4,001
1875	6,704	1902	2,490
1876	5,088	1903	3,753
1877	7,013	1904	7,631
1878	5,307		

It will be observed that the deficit had been reduced to small proportions just prior to the reduction of the rate of letter postage in 1883. — Ed.

sevenths. Compared with what it would cost the sender to evade payment, the differential rates were just; compared with what it cost to perform the service, they were absurd. And, as time went on, the absurdity increased. Improved means of communication rendered the whole cost of transmission a less important element; rapid increase of communication between distant places still further reduced differences in the cost of transmission. And with the rising feeling in favor of a system based on expense, not on profit — "freight, not tax," in the words of the day — a gradual equalization of rates for different distances was inevitable. On the continent of Europe, there was, for like reasons, a similar tendency, partially carried out, to do away with weight as an element in letter postage. This idea never took much hold in America, unless we regard the treatment of books and newspapers as an instance of it. There is no inherent reason why the post office should prefer to carry printed matter rather than written matter of the same weight. But printed matter, being habitually sent in large parcels, was, weight for weight, far easier to handle; especially so in the case of papers which went from day to day on the same routes in about equal quantities. Moreover, monopoly rates had never taken firm root here, owing to the competition of private agencies in the delivery of unsealed matter. All these reasons combined to produce the lower rates on those classes of goods.

These practical ideas are followed out in the inland postage of almost all civilized countries, whether the results are such as to more than cover or slightly less than cover the expense. In international postage it is sometimes difficult to carry them out with [illegible]. The five-cent rate was based on a rough average of transmission expenditures; and countries unfortunately situated or [illegible] may be unable to meet their foreign postal expenses on this rate. The general advantages of belonging to the postal union are a sufficient compensation for such of these inequalities as cannot be satisfactorily arranged.

19. The Post Office and Other Industries. — In 1867 Professor Jevons published the following paper upon "The Analogy between the Post Office, Telegraphs, and other Systems of Con-

veyance in the United Kingdom in regard to Government Control": [1]

It has been freely suggested of late years, that great public advantage would arise from the purchase and reorganization of the electric telegraphs and railways of the United Kingdom, by the government. So inestimable, indeed, are the benefits which the post office, as reformed by Sir Rowland Hill, confers upon all classes of society, that there is a great tendency to desire the application of a similar reform and state organization, to other systems of conveyance. It is assumed, by most of those who discuss this subject, that there is a close similarity between the post office, telegraphs, and railways, and that what has answered so admirably in one case, will be productive of similar results in other parallel cases. Without adopting any foregone conclusion, it is my desire, in this short paper, to inquire into the existence and grounds of this assumed analogy, and to make such a general comparison of the conditions and requirements of each branch of conveyance, as will enable us to judge securely, of the expediency of state control in each case.

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Much difference of opinion arises, even in a purely economical point of view, upon the question of the limit of state interferences. My own strong opinion is that no abstract principle, and no absolute rule, can guide us in determining what kinds of industrial enterprise the state should undertake, and what it should not. State management and monopoly have most indisputable advantages; private commercial enterprise and responsibility have still more unquestionable advantages. The two are directly antagonistic. Nothing but experience and argument from experience can in most cases determine whether the community will be best served by its collective state action, or by trusting to private self-interest.

On the one hand, it is but too sure that some of the state manufacturing establishments, especially the dockyards, form the very

[1] Reprinted from the Transactions of the Manchester Statistical Society, 1866–67, pp. 89–103. This essay was later included in Jevons's Methods of Social Reform (1883).

types of incompetent and wasteful expenditure. They are the running sores of the country, draining away our financial power. It is evident too that the House of Commons is at present quite incapable of controlling the expenditure of the dockyards. And as these establishments are never subjected to the test of commercial solvency, as they do not furnish intelligible accounts of current expenditure and work done, much less favor us with any account or allowance for capital expenditure, we have no security whatever that the work is done cheaply. And the worst point is, that even if government establishments of this kind are efficiently conducted when new and while the public attention is on them, we have no security that this state of things will continue.

To other government establishments, however, the post office presents a singular and at first sight an unaccountable contrast. Instead of Mr. Dickens's picture of the Circumlocution Office, we are here presented with a body of secretaries and postmasters alive to every breath of public opinion or private complaint, officials laboriously correcting the blunders and returning the property of careless letter writers; and clerks, sorters, and postmen working to their utmost that the public may be served expeditiously. No one ever charges the post office with lavish expenditure and inefficient performance of duties.

It seems then that the extremes of efficiency and inefficiency meet in the public service, and before we undertake any new branch of state industry, it becomes very important to ascertain whether it is of a kind likely to fall into the efficient or inefficient class of undertakings. Before we give our adhesion to systems of state telegraphs and state railways in this kingdom, we should closely inquire whether telegraphs and railways have more analogy to the post office or to the dockyards. This argument from analogy is freely used by every one. It is the argument of the so-called reformers, who urge that if we treat the telegraphs and the railways, as Sir Rowland Hill treated the post office, reducing fares to a low and uniform rate, we shall reap the same gratifying results. But this will depend upon whether the analogy is correct — whether the telegraphs and railways resemble the post office in those conditions which render the latter highly successful in the hands of government, and enable a low uniform

rate to be adopted. To this point the following remarks are directed.

It seems to me that state management possesses advantages under the following conditions:

1. Where numberless widespread operations can only be efficiently connected, united, and coördinated, in a single, all-extensive government system.

2. Where the operations possess an invariable, routine-like character.

3. Where they are performed under the public eye or for the service of individuals, who will immediately detect and expose any failure or laxity.

4. Where there is but little capital expenditure, so that each year's revenue and expense account shall represent, with sufficient accuracy, the real commercial conditions of the department.[1]

It is apparent that all these conditions are combined in the highest perfection in the post office. It is a vast, coördinated system, such as no private capitalists could maintain, unless, indeed, they were in undisputed possession of the field, by virtue of a government monopoly. The forwarding of letters is a purely routine and equable operation. Not a letter can be mislaid but some one will become aware of it, and by the published tables of mail departures and arrivals the public is enabled accurately to check the performance of the system.

Its capital expenditure too is insignificant compared with its current expenditure. Like other government departments, indeed, the post office does not favor us with any statement of the capital value of its buildings, fittings, etc. But in the post-office accounts, we have a statement of the annual cost of buildings and repairs, together with rents, rates, taxes, fuel, and lights. In the last ten years (1856–65) the expense

[1] It will be interesting to note the following comment which President Hadley has made upon the criteria here suggested by Jevons:

"All this is good as far as it goes; but it leaves the heart of the difficulty untouched. Passing over the first of these points, which really begs the whole question, we have before us, not an indication of the conditions under which a government can manage an industry with the best advantage, but of those under which its management is attended with the least danger. Jevons's principles are restrictive and not positive. They show how far you can trust the government without serious danger of financial mismanagement." Hadley, Economics, 398. — Ed.

has varied from £39,730 in 1864 to £106,478 in 1859, and the average yearly expense has been £72,486, which bears a very inconsiderable ratio to £1,303,064, the average cost of the post office staff during the same years. Compared with £2,871,729, the average complete expenditure of the post office during the last ten years, the cost of the fixed property of the department is quite inconsiderable. This very favorable state of things is due to the fact, that all the conveyances of the post office system are furnished by contract, while it is only the large central offices that are owned by government.

Before proceeding to consider the other systems of conveyance, I must notice that the post office in reality is neither a commercial nor a philanthropic establishment, but simply one of the revenue departments of the government. It very rightly insists that no country post office shall be established unless the correspondence passing through it shall warrant the increased expense, and it maintains a tariff which has no accordance whatever with the cost of conveyance. Books, newspapers, and even unsealed manuscripts can be sent up to the weight of four ounces for one penny; whereas, if a sealed letter in the least exceeds one half ounce, it is charged twopence.[1] It is obvious that the charges of the post office are for the most part a purely arbitrary system of taxes, designed to maintain the large net revenue of the post office now amounting to a million and a half sterling.[2]

It will thus be apparent that Sir Rowland Hill's scheme of postal tariff consisted in substituting one arbitrary system of charges for a system more arbitrary and onerous. This was [illegible] by the post office, at the time, of about one million sterling [illegible] but it must be distinctly remembered that it [illegible] was sacrificed, and not commercial [illegible]

[illegible] to me to possess the characteristics which favor [illegible] state management almost in as [illegible] as the post office. If this be so, great advantages will undoubtedly be attained by the purchase of the tele-

[1] [illegible] was raised [illegible] ounce, and in 1897 to four ounces. *Cf.* Palgrave, Dictionary of Political Economy, III, 175. — Ed.

[2] [illegible] the net revenue was £[illegible]. — Ed.

graphs and their union under the direction of the post office department.

It is obvious, in the first place, that the public will be able, and in fact obliged, constantly to test the efficiency of the proposed government telegraphs, as they now test the efficiency of the post office. The least delay or inaccuracy in the transmission of messages will become known, and will be made the ground of complaint. The work, too, of receiving, transmitting, and delivering messages, is for the most part of an entirely routine nature, as in the case of the post office. The only exception to this consists perhaps in the special arrangements which will be needed for the transmission of intelligence and reports to the newspapers.

It is hardly necessary to point out in the second place that a single government telegraph system will possess great advantages from its unity, economy, and comprehensive character. Instead of two or three companies with parallel conterminous wires, and different sets of costly city stations, we shall have a single set of stations; and the very same wires, when aggregated into one body, will admit of more convenient arrangements and more economical employment. The greater the number of messages sent through a given office, the more regularly and economically may the work of transmission and delivery be performed in general.

Furthermore, great advantages will arise from an intimate connection between the telegraphs and the post office. In the country districts the telegraph office can readily be placed in the post office, and the postmaster can, for a moderate remuneration, be induced to act as telegraphic clerk, just as small railway stations serve as telegraphic offices at present, the station master or clerk being the operator. A great number of new offices could thus be opened without any considerable expenses for rent or attendance. The government, in short, could profitably extend its wires where any one of several competing companies would not be induced to go.

In all the larger towns the cost of special delivery may, perhaps, be removed by throwing the telegrams into the ordinary postal delivery. It is understood that a scheme for the junction of the telegraphic and postal system has been elaborated

by the authorities of the post office, partly on the model of the Belgian service; and it has been asserted that the scheme would comprehend some sort of periodical deliveries. In the great business centers, at least, very frequent periodical deliveries could be made. For the services of a special messenger, an extra charge might be imposed. Prepayment of all ordinary charges by stamps would greatly facilitate the whole of the arrangements; and it has been suggested, that where there is no telegraph office, a prepaid telegram might be deposited in the nearest post office or letter box, and forwarded by the mail service to the nearest telegraph office, as is the practice in Belgium. It is evident that the number of telegrams will be increased, as the facility for their dispatch, by the united system of posts and telegraphs, is greater.

A low and perhaps uniform tariff would complete the advantages of such a system. It is supposed, indeed, that it would not be prudent at first to attempt a lower uniform rate than one shilling for twenty words, but it is difficult to see how an *uniform* rate of this amount can be enforced, when the London District Telegraph Company for many years transmitted messages for sixpence, or even fourpence.

The question here arises, how far the telegraphs resemble the post office in the financial principles which should govern the tariff. The trouble of writing a telegraphic message of twenty words is so slight that the trouble of conveying it to a telegraph office and the cost of transmission form the only impediments to a greatly increased use of this means of communication. The trouble of dispatching a message will undoubtedly be much decreased in most localities by the government scheme, and if the charge were also decreased, we might expect an increase of communications almost comparable with that of the post office under similar circumstances. Even a shilling rate is prohibitory to all but commercial and necessary communications, the post office being a sufficient resource, where the urgency is not immediate. Accordingly it is found that a reduction of charges increases the use of the telegraphs very much. In the Paris telegraphs a reduction of the charge from one franc to half a franc has multiplied the business *tenfold*.

* * * * * * *

But it must be allowed that the working expense of the electric telegraph is its weak point. The London District Telegraph Company has not succeeded in paying dividends, although their low charges brought plenty of business. The French lines are worked at a considerable loss to the government. Belgium is a country of very small area, which decreases the expense of the telegraphs, and yet the reduction of rate has caused a sacrifice of net revenue, only partially made up by the higher profits upon international messages in transit.

It is quite apparent that the telegraphs are less favorably situated than the post office as regards the cost of transmission. Two letters are as easily carried and delivered at one house as a single letter, and it is certain that the expenses of the post office do not increase in anything like the same ratio as the work it performs. Thus while the total postal revenue has increased from £3,035,954 in 1856 to £4,423,608 in 1865, or by 46 per cent, representing a great increase of work done, the total cost of the service has risen only from £2,438,732 in 1856 to £2,941,086 in 1865, or by 21 per cent. In the case of the telegraphs, however, two messages with delivery by special messenger, cause just twice the trouble of one message. The post office, by periodical deliveries, may reduce the cost of delivery on its own principles, but it cannot apply these principles to the actual operations of telegraphy; it cannot send a hundred messages at the same cost and in the same time as one, as it can send one hundred letters in a bag almost as easily as one letter. It is true that the rapidity of transmission of messages through a wire can be greatly increased by the use of Bain's telegraph, or any of the numerous instruments in which the signals are made by a perforated slip of paper, or a set of type prepared beforehand. But these inventions economize the wires only, not the labor of the operators, since it takes as much time and labor to set up the message in type or perforated paper as to transmit it direct by the common instrument. Economy is to be found, rather, in some simple rapid instrument of direct transmission, like the acoustic telegraph, than in any elaborate mechanical method of signaling. There is no reason, so far as we can see at present, to suppose that a government department will realize any extraordinary economy in

the actual business of transmission. The number of instruments and the number of operators must be increased in something like the same proportion as the messages. And as every mile of wire, too, costs a definite sum to construct and maintain in repair, it follows that strictly speaking the cost of transmission of each message consists of a certain uniform terminal cost with a second small charge for wires and electricity, proportional to the distance.

It will be apparent, from these considerations, that we must not rashly apply to the telegraphs the principles so admirably set forth by Sir Rowland Hill, in his celebrated pamphlet on the post office. When the financial conditions of the telegraphs are in many points so different from those of the post office, we cannot possibly look for any reduction of charges, to such an extent as he proposed in the case of the post office. Whatever reduction may be found possible will arise rather from adventitious points in the scheme, the economy in office accommodation, the aid of the post office in delivery, and so forth.

Under these circumstances it would doubtless be prudent not to attempt any great reduction of charges at first, and if we might eventually hope for a sixpenny rate for twenty words, it is certainly the lowest that we have any grounds at present for anticipating. And though uniformity of charge is very convenient, it must be understood that it is founded on convenience only, and it seems to me quite open to question whether complete uniformity is expedient in the case of the telegraphs.

So far, we have, on the whole, found the telegraph highly suitable for government organization. The only further requisite condition is that, as in the post office, no great amount of property should be placed in the care of government officials. If experience is to be our guide, it must be allowed that any large government property will be mismanaged, and that no proper commercial accounts will be rendered of the amount due to interest, repairs, and depreciation of such property. It is desirable that a government department should not require a capital account at all, which may be either from the capital stock being inconsiderable in amount, or from its being out of the hands and care of government officials. Now this condition can fortunately be observed in the telegraph system. The total fixed capital of

the telegraph companies at present existing is of but small amount. I find the paid-up capital of the five companies concerned to be as follows :

Electric and International	£1,084,925
British and Irish Magnetic	621,456
United Kingdom	143,755
Private Telegraph Company	95,822
London District Company	53,700
Total paid-up capital	£1,999,658

The above statement includes, I believe, all the actual working public telegraphs within the United Kingdom, except those which the London, Brighton, and South Coast, and the South Eastern Railway companies maintain for public use upon their lines. With the value of these I am not acquainted.

Omitting the Private Telegraph Company as not likely to be included in the government purchase, and having regard to the premium which the shares of the Electric and International Company obtain in the market, and the greater or less depreciation of the other companies' shares, I conceive that the complete purchase money of the existing telegraphs would not much exceed two and a half millions sterling.[1]

To allow for the improvement of the present telegraphs, and their extension to many villages which do not at present possess a telegraph station, an equal sum of two and a half millions will probably be ample allowance for the present. The total capital cost of the telegraphs will, indeed, exceed many times the value of the property actually in the hands of the post office, but then we must remember that the latter is but a very small part of the capital, by which the business of the post office is carried on. The railways, steamboats, mail coaches, and an indefinite number of hired vehicles, form the apparatus of the postal conveyance, which is all furnished by contract at a total cost in 1865 of £1,516,142. The property concerned in the service of the post office is in fact gigantic, but it is happily removed from the

[1] As a matter of fact, when the purchase was effected in 1870, three or four years after this essay was written, the government paid no less than £10,130,000. This excessive purchase price together with a pressure for low rates has made the venture less successful financially than Jevons anticipated. These facts were discussed by Jevons in a later article. *Cf.* Methods of Social Reform, 293–306. — ED.

care and ownership of government. Now this condition fortunately can be observed in the government telegraphs.

The construction and maintenance of telegraph wires and instruments is most peculiarly suitable for performance by contract. The staff who construct and repair the wires and instruments is quite distinct from those who use them, and there need be no direct communication or unity of organization between the two. Just as a railway company engages to furnish the post office with a mail train at the required hour each day, so it will be easy for a contractor to furnish and maintain a wire between any two given points. And it is obvious that the cost of a wire or instrument, and even the charge for the supply of electricity, can be so easily determined, and are so little liable to variation, that scarcely any opportunity will arise for fraud or mismanagement.

There is a company already existing, called the Telegraph Construction and Maintenance Company, which is chiefly engaged in laying submarine telegraphs, a work of far more hazardous character, but which it has carried on successfully and profitably. And it is certain that, if it were thought desirable, some body of capitalists would be found ready to construct, hold, and maintain in repair the whole apparatus required in the government service, at fixed moderate charges. Thus would be preserved in completeness those conditions under which the post office has worked with such preëminent success.

It can hardly be doubted then that if the electric telegraphs of this kingdom were purchased by the government, and placed in the hands of a branch of the post office department, to be managed in partial union with the letter post, and under the same conditions of efficiency and economy, very gratifying results would be attained, and no loss incurred. But, inasmuch as the analogy of the telegraphs and post office fails in a very important point, that of the expense of transmission, we should guard against exaggerated expectations, and should not press for any such reduction of rates as would land us in a financial loss, not justified by any economical principles.

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Some persons might possibly be opposed to this extension of government interference and patronage, as being not so much in

itself undesirable, as likely to lead to a greater and more hazardous enterprise — the purchase and reorganization of the railways.

It is well known that opinions have been freely expressed and discussed in favor of extending government management to the whole railway property of the United Kingdom. I should not like to say that this should never be done, and there are doubtless anomalies and hardships in the present state of our railway system, which demand legislative remedy. But after studying Mr. Galt's work on railway reform and attending to much that has been current on the subject, I am yet inclined to think that the actual working of our railways by government department is altogether out of the question while our English government service remains what it is.

The advantages which might be derived from a single united administration of all the railways are doubtless somewhat analogous to those we derive from the post office, but in most other respects the analogy fails completely and fatally. Railway traffic cannot be managed by pure routine like that of the mails. It is fluctuating and uncertain, dependent upon the seasons of the year, the demands of the locality, or events of an accidental character. Incessant watchfulness, alacrity, and freedom from official routine are required on the part of a traffic manager, who shall always be ready to meet the public wants.

The moment we consider the vast capital concerned in railways, and the intricacy of the mechanism and arrangements required to conduct the traffic, we must see the danger of management by a department of the English government. The paid-up capital of the railways of the United Kingdom, including the outstanding debenture loans, amounted in 1865 to £455,478,143; whereas the current working expenses of the year were only £17,149,073, or $3\frac{3}{4}$ per cent of the capital cost. More than half the receipts, or 52 per cent, go to pay a very moderate dividend of about $4\frac{1}{2}$ per cent (4.46 per cent in 1865) on the enormous capital involved. The railways are altogether contrary in condition, then, to the post office, where the capital expense was quite inconsiderable compared with the current expense. And I think I am justified in saying, that until the English government returns reliable accounts of the commercial results of the dockyards and other manufacturing establish-

ments, and shows that they are economically conducted, it cannot be intrusted with the vast and various property of the railways.

It has been suggested, indeed, that a government department would conduct the traffic of the railways by contract; but I am unable to see how this could be safely done. The care of the permanent way might perhaps thus be provided for, though not so easily as in the case of telegraph wires. But the other branches of railway service are so numerous and so dependent upon each other that they must be under one administration. As to the proposal to break the railways up into sections, and commit each to the management of a contractor, it seems to me to destroy in great part the advantages of unity of management, and to sacrifice much that is admirable in the present organization of our great companies. I am far from regarding our present railway system as perfect; but its conditions and requirements seem to me so entirely contrary to those of the post office that I must regard most of the arguments hitherto adduced in favor of state management as misleading.

I may add that should a government system of telegraphs prove successful, and should the public desire to extend state management still further, there is a most important and profitable field for its employment in the conveyance of parcels and light goods. Prussia possesses a complete system of parcel posts, and the Scandinavian kingdoms, Switzerland, and possibly other continental countries, have something of the sort. In this country the railways collect, convey, and often deliver parcels for high and arbitrary charges; a number of parcels' companies compete with the railways and with each other. An almost infinite number of local carriers circulate through the suburban and country roads in an entirely unorganized manner. The want of organization is remedied to a slight extent by the practice of passing parcels from one carrier to another in a haphazard sort of way, but at each step the parcel incurs a new, uncertain, and generally large charge. A vast loss of efficiency is incurred on the one hand by the parallel deliveries of a number of companies in each town, and on the other hand by the disconnected services of the private carriers. A government system of conveyance, formed on the model of the post

office, collecting, conveying, and distributing parcels and light goods, by one united and all-extensive system, at fixed and well-known charges, and carrying out this work by contract with the railways and with the owners of the carriers' carts in all parts of town and country, would confer vast benefits on the community, and at the same time contribute a handsome addition to the revenue. It would tend to introduce immense economy and efficiency into the retail trade of the kingdom, bringing the remotest country resident into communication with the best city shops. It would lighten the work of the post office, by taking off the less profitable and more weighty book parcels; and it would, in many ways, form the natural complement to our telegraph, postal, and money order system.[1] But a scheme of this sort is of course entirely prospective, and it seems to me sufficient for the present for the government and parliament to consider whether the reasons brought forward by various individuals and public bodies throughout the country in favor of a government system of telegraph communications are not sufficient to warrant an immediate execution of the plan.

20. Municipal Industries. — The extension of the "industrial domain" of the government has been very marked, in recent years, in the field of municipal industries. The necessity for increased public control of local monopolies was recognized by John Stuart Mill in his discussion of the cases in which it is possible to justify a departure from the policy of *laissez-faire*. Concerning private corporations or associations engaged in such monopolistic enterprises, Mill wrote:[2]

But although, for these reasons, most things which are likely to be even tolerably done by voluntary associations, should, generally speaking, be left to them; it does not follow that the manner in which those associations perform their work should be entirely uncontrolled by the government. There are many cases in which the agency, of whatever nature, by which a service is performed, is certain, from the nature of the case,

[1] In 1883 a national parcel post was established. — ED.
[2] Principles of Political Economy, Bk. V, ch. 11, § 11.

to be virtually single; in which a practical monopoly, with all the power it confers of taxing the community, cannot be prevented from existing. I have already more than once adverted to the case of the gas and water companies, among which, though perfect freedom is allowed to competition, none really takes place, and practically they are found to be even more irresponsible, and unapproachable by individual complaints, than the government. There are the expenses without the advantages of plurality of agency; and the charge made for services which cannot be dispensed with is, in substance, quite as much compulsory taxation as if imposed by law; there are few householders who make any distinction between their "water rate" and their other local taxes. In the case of these particular services, the reasons preponderate in favor of their being performed, like the paving and cleansing of the streets, not certainly by the general government of the state, but by the municipal authorities of the town, and the expense defrayed, as even now it in fact is, by a local rate.

The characteristics of these monopolistic enterprises, now generally called natural monopolies, were further elucidated by T. H. Farrer nearly a generation after Mill wrote. Farrer's discussion has had much influence upon American writers, and was, in part, as follows: [1]

Is there, then, any general characteristic by which these undertakings, or others of a similar kind, may be recognized and distinguished from undertakings which are governed by the ordinary law of competition.

It is not *large capital*, for though most of them require large capital, some gas and water companies, which are complete monopolies, have capitals of not more than two or three thousand pounds; whilst other enterprises with enormous capitals, *e.g.* banks, insurance offices, shipping companies, are not monopolies.

It is not *positive law*, for few of them have a monopoly expressly granted or confirmed by law; and in most, if not all,

[1] The State in its Relation to Trade, 69–71 (London, 1883).

of the cases where such a monopoly happens to have been so granted or confirmed, it would have existed without such grant or confirmation.

They all agree in *supplying necessaries*. But this alone is no test, for butchers and bakers supply necessaries.

Most, if not all, of them have *exclusive possession or occupation of certain peculiarly favorable portions of land* — *e.g.* docks, of the riverside, gas and water companies, of the streets. But this is only true in a limited sense of such undertakings as the post office, telegraphs, or even of roads and railways; and a mine, a quarry, or a fishery has equally possession of specially favored sites without generally or necessarily becoming a monopoly.

The article or convenience supplied by them is *local*, and cannot be dissevered from the possessor or user of the land or premises occupied by the undertaking. The undertaking does not produce an article to be carried away and sold in a distant market, but a convenience in the use of the undertaking itself, as in the case of harbors, roads, railways, post office, and telegraphs; or an article sold and used on the spot where it is produced, as in the case of gas and water.

Again, in most of these cases the convenience afforded or article produced is one which can be *increased almost indefinitely*, without proportionate increase of the original plant; so that to set up a rival scheme is an extravagant waste of capital.

There is also in some of these undertakings, and notoriously in the cases of the post office, of telegraphs, and of railways, another consideration, *viz.* the paramount importance of *certainty and harmonious arrangement*. In the case of most industries — *e.g.* in that of a baker — it would be easier to know what to do if there were one instead of several to choose from; but this consideration is in such a case not paramount to considerations of cheapness. In the case of the post office and telegraphs, certainty and harmony are the paramount considerations. The inconvenience would be extreme if we had to consider and choose the mode of conveyance every time a letter is dispatched, or if a telegram sent from any one station could not be dispatched to all other stations.

The following, then, appear to be the characteristics of undertakings which tend to become monopolies:

1. What they supply is a necessary.

2. They occupy peculiarly favored spots or lines of land.

3. The article or convenience they supply is used at the place where and in connection with the plant or machinery by which it is supplied.

4. This article or convenience can in general be largely, if not indefinitely, increased without proportionate increase in plan and capital.

5. Certainty and harmonious arrangement, which can only be attained by unity, are paramount considerations.

21. The Policy of American Municipalities. — The proper policy for municipalities to pursue with respect to local monopolies is now the subject of lively discussion both in the United States and England. From the large and growing literature dealing with the question [1] we shall have room for but a single selection, which summarizes in a judicial manner the situation in the United States: [2]

Municipal ownership of public utilities in American cities, except so far as concerns the water supply, has only recently been recognized as a possibility, much less an issue. Its advocacy, indeed, was frowned upon as savoring strongly of socialistic propaganda. The supplying of water has always been considered a proper function of government. Municipalities have also constructed and owned their sewers, and in some seacoast cities the docks are the property of the city. Into the purely industrial field of public activity, the sale of light, heat, and transportation, the building of model tenements, the ownership of telephones, and the many other industrial functions which European cities have so largely taken over, American municipalities have not, until recent years, attempted to enter.

The reason for the close limitation of the functions of gov-

[1] The following references may be suggested: Major Leonard Darwin, Municipal Trade (New York and London, [illegible]); E. W. Bemis, editor, Municipal Monopolies (New York, 1899); Municipal Affairs, Vol. VI, No. 4 (1903).

[2] The Recent History of Municipal Ownership in the United States, by Charles Waldo Haskins. In Municipal Affairs, Vol. VI, pp. 524 *et seq.* (1903). Reprinted by permission of the Reform Club.

ernment we are not called upon to discuss. Our present concern is with the evidences of a departure from the traditions of individualism and the development of a considerable body of influential opinion in favor of an extension of the field of city activity. Within the last five years a movement has developed in favor of the ownership of public utilities which promises to accomplish considerable results. It is the purpose of this paper to present some of the leading features of the movement.

EXTENT OF MUNICIPALIZATION

At the close of 1902 the situation of municipal ownership was as follows: Out of 1475 water-supply systems reported for cities of 3000 and over, 766, or 51 per cent, were owned by municipalities, 33 were owned by both city and private company, 661 were owned by private corporations, and 14 were owned jointly. In the larger cities of more than 30,000 inhabitants, out of 135 plants, 88 were owned by the city. As the municipality decreases in size, the proportion of privately owned plants increases, being largest in towns of between 5000 and 30,000 inhabitants. The percentage of water plants owned by the public is largest in the North Central states, and smallest in the South Central states.

Public ownership of the water supply is an accomplished fact, so firmly established and so familiar that it is not usual to argue from its existence to the desirability of extending the system to other public utilities. The supplying of water being so closely concerned with the public health, ranks in the public mind with the provision and maintenance of sewers, the cleaning of the streets, and the inspection of food and milk.

When we turn to lighting and transportation, however, we see that the provision of water is a peculiar and unique fact which finds no parallel in other parts of the field of public service. Out of 981 municipalities which are reported as having gas works, only 20 cities own their gas plants. The five largest of these cities are Philadelphia, Louisville, Richmond (Va.), Duluth, and Wheeling (W. Va.). Excluding Louisville, where the city is only part owner of its gas works, only one large city, Philadelphia, is the owner of its gas plant, and in Philadelphia

the plant has been leased to a private company until 1927. Municipal ownership has made little progress in the field of gas lighting.

Electric lighting is a more recent development than gas lighting, and it is natural to expect that if the sentiment in favor of public ownership is growing, it would find expression in this field. This we find has been the fact. Out of 1471 cities of 3000 reporting systems, 193 were owned outright by municipalities, 85 were owned by both city and private company, and 1190 were owned by private companies. Few of the large cities, however, own their electric lighting plants. Out of 135 systems in cities of more than 30,000 population, 121 were owned by private companies, 10 were owned by both, and only 4 were owned outright by the cities in which they were located. The largest proportion of publicly owned plants is found in towns of from 3000 to 5000 inhabitants, where, out of 579 reported, 111 were owned by the municipality, and in 18 cities plants were owned both by the municipality and a private company.

The largest percentages of publicly owned electric lighting plants were situated in the North Central and South Atlantic states, and a much smaller percentage in the New England and the Middle Atlantic states. It is to be noted, moreover, that Chicago and Detroit are the only cities of the first class owning lighting plants, and that, for most of the larger cities which manufacture electricity, public activity is restricted to the lighting of streets and public buildings, leaving the field of commercial lighting to the private company.

It is when we examine the ownership of street railways, however, the most difficult and costly of these public services to administer, that we see how small is the progress of the municipal ownership movement. Out of 928 companies reported in 1902, only one, in Grand Junction, Col., was owned by a municipality.

To summarize the progress made, we find (1) that waterworks are generally owned by municipalities, and that the proportion is increasing; (2) that a few electric lighting plants in cities and a large number in smaller towns are publicly owned, but that while the number of public plants tends to increase, the proportion to private plants does not increase; (3) that in the

supplying of gas and transportation, American cities have done practically nothing; the abandonment of its gas works by Philadelphia, the only large city which had undertaken the conduct of this service, raising grave doubts as to the desirability of a general municipalization of this service.

Growth of Public Sentiment

It is evident that if there is a movement toward municipal ownership, it is as yet confined to the formation of public opinion, a necessary preliminary to any practical results. An investigation of the evidences of public sentiment shows the existence not merely of a widespread interest in the subject of municipal ownership, but of a growing demand, particularly in the West, that radical action should be taken.

Clergymen and collegians, who may usually be depended on to voice conservative opinion, have in recent years been outspoken in favor of municipal ownership of public utilities. The League of American Municipalities and the National Municipal League have also indorsed the movement. More conclusive evidence, not merely of a growing interest in the subject, but of a conviction that a change is desirable, is furnished by the press. An examination of the files of a number of leading newspapers for two years past shows two tendencies: (1) a universal interest in the subject and a disposition to give an increasing space to its discussion; (2) a growing number of journals which advocate municipal ownership in one form or another. The more conservative journals — even those whose sympathies are on the side of private capital — dignify the movement by an increasing space in their columns.

More significant is the appearance of the issue in politics. Chicago, St. Louis, Detroit, Cleveland, New Orleans, Columbus, Denver, Nashville, and San Francisco are important cities which have within the last four years brought the issue forward in political campaigns.

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Trend of Legislation

Municipal ownership has figured with increasing prominence in the legislation of recent years. An examination of the legis-

lation on this subject for the past ten years shows the following tendencies on the subject of municipal ownership:

(1) Increased authorization of municipalities to erect, lease, purchase, and operate waterworks, lighting plants, and in a few cases street railways;

(2) Permission to issue bonds beyond the present authorized limit, or to tax for the special purpose of building or acquiring municipal plants;

(3) An increasing use of the referendum in deciding purchases or granting franchises;

(4) Limitation of the length of franchises and of lighting contracts, and permission granted to municipalities to regulate rates.

Within the past ten years (1891–1901) the permission to own, erect, and purchase water or lighting plants for cities of varying sizes has been extended to municipalities by twenty-four states. California and Kansas have passed very general laws providing for municipal ownership, and the cities of San Francisco, Fresno, and Pasadena have new charters with municipal ownership clauses. Denver has also obtained extended powers. Permission to furnish heat and power is of special interest in Western states.

The distrust of elected representatives and the desire of the people to safeguard their interests by referring questions affecting public utilities to a popular vote is seen in a growing use of the referendum. Many of the enabling acts above mentioned provide for referring the questions involved to a popular vote. Minnesota provides the referendum for the purchase or erection of water or electric light plants in villages, or in case of an exclusive franchise; Illinois, New Jersey, and Kansas for the building or purchase of waterworks; Iowa in case the municipality wishes to sell a plant; Nebraska for any ordinance on demand of 15 per cent of the voters; and Indiana for any ordinance to purchase a plant on demand of 40 per cent of the voters. A notable example of the referendum is the recent vote of Chicago.

The limitations of franchise take the form of (*a*) submission to popular vote, either required, or upon petition of part of the citizens; (*b*) specifications as to the manner of granting fran-

chises, for example, by advertising, by auction, or by competitive bids; (*c*) limitation of the term of franchises; and (*d*) control of rates.

A feature of especial interest in the present connection is the provision for ultimate municipal purchase. This provision is found in Florida, where the right to purchase is reserved; in Colorado, after 20 years; in Indianapolis, in the charter of 1899, at the end of the franchise; and in Virginia, where the right of purchase is reserved.

In addition to the cases mentioned under the referendum, Tennessee (for cities of 36,000) and South Carolina (by a two thirds vote) require an expression of popular will before a franchise can be granted, and California, Missouri, and Virginia require that franchises should be put up at auction, and sold to the corporation promising the highest percentage of gross earnings. The percentage of earnings paid to the municipality must amount at least to two per cent for the first five years in Missouri, and three per cent in California. Wisconsin requires competitive bids.

Franchises have been limited to 20 years in Kansas and 10 years in Minnesota, where exclusive. Massachusetts has legislated for control of street railways, and special rates are required to be given to school children. The Indianapolis charter requires that street railway companies shall sell six tickets for 25 cents, and universal transfers.

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What does our Experience Show?

What, now, does the recent history of municipal ownership tell us of its success and its probable future? First, it must be admitted that the few experiments which the larger cities have made in operating the more difficult services of gas and electric lighting are not conclusive one way or the other as to the practical expediency of municipal ownership. In other words, it has not yet been definitely established that municipal operation of public utilities results in cheaper and better service than is attained under private ownership, nor, on the other hand, do the results achieved point unmistakably to the conclusion that public ownership is less economical than private ownership. The four most

conspicuous examples of public ownership which have been used in recent discussions to furnish evidence in support of one or the other conclusion, are the Philadelphia gas works, the electric lighting plants of Chicago and Detroit, and the change from private to public ownership of gas and water plants in Duluth. Of these the first is commonly cited to prove the relative inefficiency of public management, and the three last mentioned are advanced in support of public ownership.

The evidence, however, is by no means conclusive. It is true that Philadelphia is receiving a larger revenue from the lease of her gas works than was ever derived from public ownership; that the quality of gas furnished is superior, while the service is on a much higher plane than that rendered by the municipal employees. It has not been proven, however, that a competent administration backed up by a less conservative community might not have secured, by a reconstruction of the gas plant, and a thorough renovation of the administration, a much larger return than is derived from the United Gas Improvement Company, for the earnings of this company are large and increasing, and they might all, conceivably, have been secured for the community. So far as Philadelphia is concerned, there is no doubt that municipal operation was a failure. In view of the peculiar characteristics of the citizenship of that city, however, it is unsafe to generalize from its experience.

The municipal electric lighting plant in Chicago was examined during 1901 by Haskins and Sells, of New York, and the results of the examination reported to the Reform Club were that during the thirteen years, 1887 to 1900, the city of Chicago paid $49,423.11 more for electric lighting than if the lights had been rented from the private companies. This discrepancy is so small as to leave the issue between the two systems in doubt, so far as the face of the returns shows anything of the relative efficiency of the two systems. Certainly the result cannot be urged against municipal ownership.

Moreover, Professor John R. Commons, in a critical review of this report, has suggested certain favorable considerations from another point of view, some of which the accountants could not notice, but which should be included in any estimate of the significance of Chicago's experience. These are in brief: (1) that

the city paid higher wages for shorter days than the private company; (2) that the great reductions in the rentals paid to the private companies for the lights which they furnish to the city were due to the ability of the city, because of its ownership of a plant, to drive a good bargain with the companies; (3) Professor Commons claims that the depreciation charges of the accountants were too high; and (4) that the loss from taxes on the property which the city has owned is excessive because the private companies have paid taxes on a valuation less than half the true value of the property. As a result of this revision of the accountant's report, Professor Commons reduces the estimated cost per lamp from $123.81 to $106.55.

Without expressing an opinion on one side or the other, it is significant that such wide differences exist between the estimates of competent investigators. It is obviously unsafe to draw conclusions from such disputed evidence. The experience of Detroit, Duluth, Wheeling, Grand Rapids, and various smaller cities which have reported, seems to show a saving from municipal ownership. The evidence, however, as above remarked, of these few isolated examples, is inconclusive.

Probable Future Development

Moreover, as John Stuart Mill pointed out half a century ago, the question at issue is not between private property, as at present managed, and public ownership — if this were the only alternative, municipal ownership might be generally approved — but between private property, as it might be managed, and public ownership. In other words, while the experience of various cities, particularly in Great Britain, may be taken to indicate a balance of advantage in favor of municipal ownership, this is not finally conclusive as to the merits of the question. We should, on the other hand, compare the results of municipal ownership with the results of the present system, freed so far as possible from its abuses.

Before indorsing so radical a departure from established practice as is involved in public ownership of gas plants and street railways, we should first consider the possibility of improving the service, lowering its charges, and increasing the

contributions of private companies to the public treasury. In a strongly individualistic community like the United States, we should expect that the line of development would be as follows: (1) a recognition of abuses; (2) a protest against those abuses and a trial of various methods of remedy; and finally, and only if remedial measures failed, a radical departure from precedent in the abolition of private property within those fields where it had been shown unfit longer to exist.

The evidence thus far presented follows this line of development. There is a general recognition of abuses and a vigorous and widespread demand for a change, which has apparently taken the form of a movement toward municipal ownership. It is, however, in the nature of things, altogether probable that this movement will expend itself in accomplishing much-needed reforms. This conclusion is supported by other than inferential evidence. The demand for municipal ownership is already resulting in important concessions to public sentiment on the part of private companies, which promise to accomplish the desired ends without resort to drastic measures. In brief, private companies are offering to accept shorter franchises, to improve their service, to reduce their rates, to increase their contributions to the public treasuries, and to take the public into their confidence. They make these concessions, it is true, under practical compulsion; but they are none the less important on that account.

CHAPTER VII

FEES

22. The Nature of Fees: Eheberg's Views. — Ever since the time of Rau[1] most writers have treated fees as a distinct branch of public revenue. There has been, however, no general agreement concerning the precise definition of a fee. Rau himself gave the following definition:[2]

Fees are charged upon occasions when the citizen comes into contact with the government or some of its agencies. They can be considered a partial compensation for the expenditure which the particular act of government occasions, and so far resemble a payment made for a service rendered by a private person. But on the other hand, the governmental institution which gives occasion for the collection of a fee is not conducted for the purpose of obtaining such dues; on the contrary, it arises from the duty of the state to seize upon all expedient means of fulfilling its purposes."[3]

[1] Even before Rau, however, Adam Smith had recognized the existence of fees. Smith said, for instance:

"The expense of the administration of justice, too, may, no doubt, be considered as laid out for the benefit of the whole society. There is no impropriety, therefore, in its being defrayed by the general contribution of the whole society. The persons, however, who give occasion to this expense are those who, by their injustice in one way and another, make it necessary to seek redress or protection from the courts of justice. The persons, again, most immediately benefited by this expense are those whom the courts of justice either restore to their rights or maintain in their rights. The expense of the administration of justice, therefore, may very properly be defrayed by the particular contribution of the one or other, or both of those different sets of persons, according as different occasions may require, that is, by the fees of court." Wealth of Nations, Bk. V, ch. 1.

[2] Finanzwissenschaft, § 227.

[3] With this definition we should compare other more recent ones. Roscher says that fees are "payments made for individual acts of government, by those persons who have been the direct occasion of the action." Finanzwissenschaft, § 22. Wagner

The following account of the nature of fees is from a representative German writer. K. T. Eheberg:[1]

Fees are special charges fixed by the state for special demands upon public officials or institutions, and are paid by the persons who have occasioned these demands for the services or action of the government. Accordingly the distinguishing characteristic of the fee, that which differentiates it from a tax, is the fact that a fee is collected in connection with some definite action of public agents and as compensation therefor.

Fees arise only in connection with such public institutions and officials as are maintained for the sake of the general public welfare in order to secure essential public ends. These institutions would have to be maintained in any case even if their services were seldom needed, but their action is occasioned by the demands of particular persons. The occasion for the demands, and therefore for the payment of a fee, may be of two sorts: either the individual calls for the intervention of the public agencies in cases where his personal interest is the same as that of the public, or he seeks in his own interest to obtain special privileges. The first case arises, for example, in connection with many of the fees for administering justice or inspecting weights and measures; the second arises where the individual obtains special advantages through exemption from legal regulations or special concessions, such as patent rights and similar privileges. In all these cases the institution itself, which serves partly public and partly private ends, is maintained wholly or partly at public expense; but the cost of the individual acts is defrayed more conveniently, in whole or in part, by fees collected from those who have occasioned the expense.

From these remarks we can deduce the leading principle for

says: "Fees are charges, arbitrarily fixed by a government in amount and method of payment, which individuals or groups of individuals pay as a special compensation for some service rendered by a public body, or for some expense which the individuals have caused the state in the exercise of its functions." Finanzwissenschaft, § 277. And Seligman gives the following definition: "A fee is a payment to defray the cost of each recurring service undertaken by the government primarily in the public interest, but conferring a measurable special advantage on the fee-payer." Essays in Taxation, 304.

[1] Finanzwissenschaft, §§ 71–73.

determining the amount of a fee. In the first case just described, the expense which the individual has occasioned should be the basis for determining the sum charged him; in the second case, the measure of the fee should be the value of the privilege which is accorded him. In this measurement it is necessary to consider how great the public interest is in the service or act performed. The greater the public interest in the particular branch of administration, the lower should be the fees charged therefor; the smaller the public interest, the higher the fees ought to be. For this reason fees are fixed according to the value of the service, when special legal advantages are granted or an exception is made in the application of a general law.

On account of the varied nature of fees it happens, to be sure, that these two principles for measuring their amount pass over into one another. And since the actual adjustment of fees in different countries is materially affected by historical conditions and by the other public charges, we can in practice demand no more than that the principle just laid down shall be generally followed. In general we can say merely that, as a rule, charges should be no higher than is necessary to meet the average cost of running the office concerned, and that in particular cases the fee may be above or below this average level.

It is contrary to the nature of a fee that the ability of the particular contributor should be considered in determining the amount. That does not prevent us from exempting persons from fees in case of poverty, or straitened circumstances combined with special merit, in order to secure even to the poor the benefit of public institutions, such as courts of justice and schools. Exemption from the fee in the first case is charity; in the second a reward, bestowed upon persons without means at the expense of those better circumstanced.

By the characteristics above mentioned fees can be, at least in theory, sharply separated from all other forms of income. They are distinguished from the economic income of the state by the fact that, with economic income, the use of and resort to the services of the state is free and the price is governed by competition; while with the fee the state, by its power of compulsion, obliges the individual to resort to public agencies and fixes arbitrarily the payment made therefor. And they are dis-

tinguished from taxes by the fact that, with fees, the ruling principle is special payment for special service, of special reckoning in each case between the treasury and the contributors; while, with taxes, the ruling principle is general contributions for general services, that is, general contributions for the expense of maintaining order and promoting the welfare and culture of the people. If the duty to pay taxes follows from the fact of membership in the state, the duty of paying fees arises only as a result of making a special demand upon public institutions.

Of course in practice taxes and fees easily pass over into one another. Not infrequently charges known as fees are so high that there is no relation between the cost of service and the charges in question. Also occasionally charges which are nothing but taxes are called fees, either as a result of their historical relations or because they are actually associated with fees. That is true particularly of duties upon the transfer of property, for this transfer not only is attended with fees, since it requires some action by public officials, but it gives occasion many times for the imposition of taxes.

23. The Fee System of our Federal Government. — Professor T. K. Urdahl, in his detailed study of the fee system in the United States, gives the following account[1] of the fees collected by the federal government:

A. Patent and Copyright Fees

To the public generally the best-known system of fees collected under the federal laws is undoubtedly that connected with the National Patent Office. This office is one of the institutions which were conceived and established by Jefferson in 1790. Before that date some of the states had by legislative acts granted copyrights and patents for short periods of years, but none of them had any complete system. True to the ideas then current, that fees should pay salaries directly, and should only be sufficient to make the public institutions self-supporting,

[1] Reprinted, by permission of the author, from The Fee System in the United States, pp. 141–147. Published in the Transactions of the Wisconsin Academy of Sciences, Vol. XII (1898).

Jefferson made the patent-office fees very low, and allowed all of them to be collected as salaries by the patent-office officials. But the receipts were found to be inadequate to pay expenses; so in 1793 a law was passed which increased the fees to six times the former amount. This continued in force up to 1836, when a new act was passed which provided that patent officials should be paid salaries, and that all the fees collected should be paid into the treasury. The patent-office fees remained about the same for United States citizens, but foreign applicants were compelled to pay much larger sums for patent rights. Provision was also made for the right to extend the life of a patent, and a fee of $40 was to be collected for each extension. This schedule remained in force up to 1861. Congress then passed an act which reduced most of the old fees by one half, but enlarged the fee bill so as to require payments for official acts which up to that time had been free. The discriminations against foreigners were also repealed.

With slight changes this schedule has remained in force up to the present. New duties are gradually taken over by the patent office, because the sphere of invention becomes broader with every new discovery in science, and the technicalities of patents and patent rights become more complicated. New fees are therefore constantly being introduced to pay for the more elaborate and thorough examination which must be taken in the interest of the patentees.

The copyright law has been subject to less change than the patent law, and the fees have remained uniform almost from the beginning. The first act, passed in 1790, fixed the copyright fee at 50 cents, and provided for a reissue on payment of another fee of the same amount. These charges continued unchanged in all the subsequent acts, except that a recent law has taken all the fees out of the librarian's salary and required their payment into the treasury.[1]

[1] The applicant for a copyright is required to deposit two copies of his book with the librarian, the cost of which may in one sense be reckoned as a part of the copyright fee. There are, however, other fees collected by the librarian, which are not absolutely necessary to the validity of the copyright. As such may be mentioned a fee of 50 cents for each copy of the certificate, and one of $1 for recording the assignment of a copyright.

B. Custom-house and Other Import Fees

The very first law levying import and tonnage duties made provision for the payment of all officers connected with the custom-house, by means of fees. Surveyors, weighers, gaugers, inspectors, and collectors, each had their own fees defined by this early act of 1789. Clearance and entrance fees for ships were varied according to the tonnage. For ships of less than 100 tons, the fee was $1.50, while all ships of over 100 tons were required to pay $2. Payments were also made for permits to land goods and for each bond procured. In 1789 the coasting and fishing trades were put under special regulation by means of licenses, for each of which a fee of 50 cents was collected; and in addition a fee of $10 was charged for each certificate of enrollment. Foreign vessels were placed under similar restrictions and compelled to pay for any privileges granted them. This schedule of fees continued in force for two decades, when it was decided to vary the amount according to the importance of the port of entry, and a salary was added to the fees of office in some of the Northern and Northwestern ports. A decade later, in 1831, an act was passed which required all the fees collected in the Northern customhouses to be paid into the treasury, and placed the customs officials of that section on a salary. Up to 1864 most customhouse officials of the Atlantic seaboard received as compensation all the fees collected at their respective offices. The enormous sums which some of these positions yielded finally became known, and as a result Congress passed an act making $9500 the maximum amount which any collector should be allowed to retain, and providing that any excess above this amount should be paid into the treasury. These provisions, however, did not prove satisfactory. So in 1879 a new law was enacted which provided a schedule of fees to be exacted from all who had dealings with the customs service. These multitudes of fees, consisting usually in small, vexatious exactions, were in many cases inadequate to compensate the officers concerned, except in the busy ports, where they aggregated enormous sums. One of the sections of the last-named act provided fixed salaries for naval officers, collectors, and surveyors of the chief ports. There was no reason why this

provision should not have been extended to all the other officers connected with the customs service, especially since action to this effect had been repeatedly recommended by the secretaries of the treasury.

The tariff of 1890, known as the McKinley bill, abolished all fees exacted for oaths except so far as provided in the act itself. It also placed all officers on salaries equal to the amount of fees which each would have been entitled to receive for his services during the year. This was a step in the right direction, but only a very small one, as the salaries were left just as indeterminate and unclassified as ever.

C. Licenses to Vessels

In 1864 a new standard was adopted for estimating the fee or charge for each permit or license to vessels, in that the fee was made to vary from 25 cents to $1 according to the tonnage of the vessel. Fees for permits to vessels belonging to foreigners were fixed higher than those of citizens of the United States. Then came an act in 1871 fixing the license fee as $25 for a vessel of 100 tons burden, and charging 5 cents extra for each ton over that limit. The same change is noticeable in the fees which were allowed for measuring vessels. Similar standards are applied to boat-inspection fees. The first law on this subject was enacted in 1838, and fixed a fee of $5 for the inspection of any vessel, and the same for each boiler inspection. In 1852 vessels were divided according to tonnage into four classes ranging from 1000 tons to less than 125, the fees varying from $35 to $20. This schedule remained in force up to 1884, when inspectors were paid salaries; and the fees, which were fixed at $10 for a vessel of less than 100 tons and 15 cents extra for each additional ton, were collected for the treasury.

D. Miscellaneous Maritime Fees

Numerous other fees were from time to time collected for licenses to carry on maritime and other pursuits. Wreckers and pilots were compelled to obtain licenses at a cost of $5, besides a fee of $1 for each annual renewal of the same. In

1864 this charge was increased to $10 for each license. A few years later the captains, mates, and engineers were placed under the same requirements. From 1872 shipping commissioners were allowed a fee of $2 for each man engaged by them for a crew, and 50 cents for each certified discharge. This law was modified in 1884 in such a way that all the fees of the shipping commissioners were required to be paid into the treasury.

E. Court Fees

Most of the inferior officers of the federal courts were, until quite recently, allowed to retain some or all of the fees connected with their respective offices; nor had any serious attempt been made to reduce the income derived from fees to any fixed amount, until the act of 1853, by which the allowance of deputy marshals was limited to 75 per cent of the fees earned by them. This was followed by an act requiring marshals to give an account of all fees collected, which finally resulted in the act of 1878 fixing the maximum compensation of United States marshals at $6000, to be paid out of the fees earned after the office expenses had been deducted. The clerks of the United States courts have continued to receive fees as salary down to the present; and only slight changes have been made in the original bill regulating their fees, for the most part in increasing the number of acts for which fees might be collected. United States district attorneys have also received the fees collected for their services almost up to the present. It is only within the last year that these positions have become salaried. The territorial court officials still receive many fees for numerous services which are usually performed by other officers in the states. For example, fees for marriage licenses, recorders' fees, and the like are still received by them.

F. Land-office Fees

It is in the land office that we first see the government change from a fee system of compensation to a salary system. The prospect of gradually increasing government land sales made it evident that the fees in many offices would greatly exceed the legitimate compensation for the work performed; and it was

equally evident that no adjustment of the schedules could bring about an equilibrium between work and pay. So, as early as 1818, we find an act which gave the land-office registers and receivers an annual salary of $1500, besides one per cent of the money collected by their respective offices; provided, however, that no salary should exceed $3000 per annum. But even this provision made a position in the land office of a rapidly growing state exceedingly desirable. Hence in 1859 another act was passed which limited the salary of registers and receivers to $2500 in Western and $3000 in Pacific states. The land-office fees constituted a very large part of the original price of the land. In the Pacific states the fees were 13 per cent of the total price, in some of the others they constituted 11 per cent, and in many cases even more. When the surveyors' fees are added to these, one can realize what an important item in the cost of the public land these fees were. It must be borne in mind also that the fees had to be paid, even though the land was obtained by pre-emption, by tree claim, or in any other manner. The land-office fees have at times been used by unscrupulous officials as instruments for carrying on some of the most notorious and fraudulent land swindles, to the injury of actual settlers.

G. Miscellaneous Fees

The consular and diplomatic offices collect each year certain fees for passports, consular papers, and other services. Originally these formed part of the salary of the consul or minister, as did the fees collected in the consular courts; but in 1860 these officials were required to account for all fees received in any way in the exercise of their judicial authority. Many of the fees were diminished in amount and some of them entirely abolished by the act of 1891. Postmasters were also paid originally by means of fees; and a remnant of the old system exists even to-day, in the fact that the salary of postmasters in small towns depends upon the average receipts of their respective offices for the four years preceding. As far back as 1845 an attempt was made to limit the compensation of these officials by an act which provided that none of them should retain more than $5000 per year including his salary. Any excess should

be accounted for and paid into the treasury. This act was soon superseded by the present law. Other fees regulated from time to time by Congress are the municipal fees of all kinds in the District of Columbia. Fees for liquor licenses and for licenses to innkeepers, peddlers, and many other occupations, have been fixed and changed again and again by Congress. One act which illustrates very well the tendency of changing from fees to regular salaries is that of 1842, which expressly prohibits any police official in the District of Columbia from receiving any gift, fee, or emolument other than his regular salary.[1]

24. Some Typical Fees collected in American State and Local Governments. — Fees collected by authority of state or local laws are so numerous that only a few typical cases described by Professor Urdahl[2] can be given here:

1. *Fees for oil inspection.* — First and foremost in importance is the inspection of oil or petroleum, if we may judge by the number of states which have deemed it necessary to enact compulsory oil-inspection laws. The oil-inspection legislation prob-

[1] Elsewhere (p. 191) the author says:

"Federal fees are the only ones of which anything like complete accounts are kept, and even here the reports are not detailed enough to make an exhaustive treatment possible. A special report made by the Secretary of the Treasury to Congress, stating the receipts and expenditures of the federal government for the year 1882, is the basis of the following table, which contains the aggregate of all the fees, excluding postal fees, collected by federal officials of that year":

Consular fees	$613,422.22
Steamboat fees	279,889.36
Registers' and receivers' fees	1,107,671.61
Marine hospitals	406,103.59
Weighing fees	48,638.17
Customs offices	480,728.69
Emoluments (customs)	368,822.74
Emoluments (judiciary)	25,315.39
Patent office fees	917,897.14
Passports	20,115.00
Copying (general land office)	8,247.90
Copyright fees	15,753.04
National health laws	1,647.68
Total	$4,564,390.85

[2] The Fee System in the United States, pp. 155–156, 161–163, 163–166, 174–175, 186–189.

ably originated in the frequent explosions and consequent fires due to the inferior quality of the oil at first put upon the market. The modern oil-inspection laws may roughly be said to begin about 1880. A few instances may be found earlier, but the subject did not become of much importance until the great American oil fields had been discovered and exploited. Indeed, it is the aggressiveness and power of the Standard Oil and other companies, in keeping up the price and lowering the quality of the oil, which may largely be considered the cause of the later legislation on this subject. The consumption of oil increased enormously, until it became a necessity to everybody; and as the quality gradually deteriorated, popular discontent made itself felt in the form of legislation prohibiting the sale of any oil below a certain quality. Public oil inspectors were provided, usually by appointment, whose compensation consisted in fees fixed in amount by law. In general these were determined by the quantity offered for inspection at the time, usually a certain number of cents per barrel. Many states make the fees regressive in amount, in that the charge per barrel decreases as the number of barrels inspected at the time increases, from forty cents for a single barrel to ten or fifteen cents if over ten barrels are inspected at one time; while one state provides that the inspector shall be paid by the hour. The other state laws on the subject fix the fee per barrel ranging in amount all the way from ten to twenty-five cents, with no reduction for large quantities. Nebraska pays its oil inspectors fixed salaries. Minnesota requires all oil-inspection fees to be paid into the treasury, and other states limit the amount which an inspector can receive as his official income to a certain maximum.

2. *Fees for marriage licenses.*—The oldest and most common form of license regulations which has existed, and which exists to-day in some form or other in every state or territory in the Union, is that of the marriage license. This is one of the first and perhaps the most important of the regulations affecting that fundamental institution of human society—the family; and upon the character of this regulation depends the success or failure of the only direct interference which the state exercises over the marriage relation. It is an important function, which most states have neglected to exercise in the interests of society.

Only twenty-one states require any returns of marriages to be made to any state officer, and but few commonwealths have compulsory registration of marriages. It would take too long to give even an outline of the public services performed for which the license fee is charged, much less to trace the causes which brought about the legislation. Suffice it to say, that the number and nature of the requirements, as outlined in the statutes of the different states, varies very decidedly. One state requires a statement of the age of the parties and proof of their competency to contract marriage, before the license shall issue; another prescribes that bonds be given as a guarantee that the parties are entitled to marry; another simply prescribes that the license, or the application for a license, be recorded in some office. Louisiana gives the probate judge power to suspend marriage, if any objections are raised, until a hearing has been had. Maine requires a notice of intention to marry to be recorded with the town clerk five days before the license is granted. Maryland requires an examination of the applicant for license, under oath, to ascertain whether any legal impediment to his or her marriage exists. Massachusetts requires notice of intent to marry. Pennsylvania requires parental consent in certain cases. These and many other requirements are deemed important enough to be enacted into law, and for the exaction of fees for the services performed by the officials in carrying them out. The enforcement of these laws, in thirty-five states, is left to a mere clerical official, — the county clerk, county recorder, or some other registering official. In the other states the licenses are dispensed by the county or probate judge. The fees for these services of the officials, and for the license proper, vary from 50 cents to $3. Several states require the fee for the license proper to be paid into the state treasury, and give the officials power to collect extra fees for their services. Most states, however, give the fees as perquisites of office to one or more of the officials concerned. In many of these cases the marriage license fee loses its most important function, namely, that of regulation. It was originally intended to be a payment for a privilege granted only in cases where it appeared advisable. Under this system, the pecuniary interest of the official is in many cases diametrically opposed to his plain duty under the

law. As a matter of fact, it is notorious that marriage licenses are rarely refused in any state. It is largely to this system that we owe the large number of wild and runaway marriages oftentimes contracted by mere children.

3. *Fees for liquor licenses.* — To the great majority of the people, the word "license" will call to mind, or will mean, simply the permit to sell liquor, which is obtained in most states on payment of a certain sum of money. The license legislation on this subject alone, when taken together, shows a greater diversity in the different states than would at first thought seem possible. In most of the original states the license charges, as they exist to-day, are the result of a gradual increase of the amount charged at the beginning of the century. For example, the license fee in Rhode Island has increased from $4 in 1822 to $400 in 1896. Many of the new Western states have of course adopted laws which are taken directly from the statute books of Eastern states, and some of them have attempted new experiments in license legislation. Scarcely two states have exactly the same system. One state grants all the licenses directly through a state official, and receives all the fees into the state treasury; another state leaves both the power to grant the license and the revenue therefrom to the local political units. One commonwealth has a license or excise commission which grants all licenses and turns half the proceeds into the state treasury and grants the other half to the counties and municipalities. In some states the counties are the most important political units, and the county commissioners or county boards are given power to grant all licenses. In others the cities, villages, and towns are given this power, and are allowed to use some or all the revenue derived from this source. But as a rule the state legislature gives the counties, cities, or towns power to grant the license only under the conditions it prescribes. In some states these are allowed a great deal of latitude in imposing restrictions on their grants, and oftentimes, too, in prescribing the amount of the fee. In a few states the localities are given "local option," as it is called, or, in other words, power to allow or entirely prohibit the sale of liquor within their boundaries.

4. *Fees for incorporation of companies.* — An incorporation fee is in most cases collected for filing the charter of articles

of incorporation. Six states charge only $5 and two charge less than this amount, while all the rest charge amounts varying from $5 to $100 for this service. It should be borne in mind, however, that the incorporation fees include all the charges made by the state under various heads, and that the total amount, instead of the individual fees, is the important consideration. The most common and the fairest method of gauging the incorporation fee is to make it proportional to the amount of capital stock. Five states have adopted this method in full, and charge from 10 cents to $1 per thousand dollars of authorized capital stock. Six other states have a slight modification of this system, in that they charge a certain minimum fee for any amount of capital stock up to a certain limit, and then collect from 50 cents to $1 per thousand of capital stock over this amount. A very large corporation would, under this latter system, yield some revenue to the state treasury. These fees were originally designed only to cover the expenses incurred by the state in granting incorporation rights and regulating them when granted.

5. *Fees for judicial processes.* — Sheriffs, constables, clerks of court, and other court officers are, as a rule, remunerated in the same way. In the older states scarcely any changes in this part of the fee system have been accomplished. The result is, that many of the court officials are receiving fees which were designed for conditions existing from fifty to one hundred years ago. Not only are the fees entirely unsuited in amount to the modern conditions, but many of the primitive forms and formulas are clung to with great tenacity. The following example will illustrate this: In the early courts the sheriff was usually the jailer, court messenger, and constable; this custom, once established, has been continued in most of the older states, and as a result the sheriffs pocket enormous amounts of fees for services which they are supposed to perform in these three distinct capacities.

In spite of the numerous and heavy fees the courts are nowhere self-supporting. Not even those courts which deal exclusively with civil cases and have all their docket fees and other fees are able to maintain themselves without heavy drafts upon the state or local treasuries. Reforms to remedy this

have been proposed, now in one state, now in another, but the legislatures of the older states have not been able to rectify even the most glaring inconsistencies. The only states that have attempted any reform or solution of these problems are a few Western commonwealths, which are less hampered, and freer from the influence of old customs, traditions, and institutions. These have succeeded apparently in taking some decided steps in advance of any Eastern state.

Colorado, by an act passed in 1891, divided the counties of the state according to population into six classes, the first class containing all counties having a population of over 50,000, and the sixth class all those of less than 3000. The fees of all county or court officers were graded according to the class in which the county happened to be. It was further provided that all county officers should be paid salaries fixed by law, and that all fees or emoluments of office of every kind should be accounted for and paid into the treasury. Idaho passed an act in 1887 based on a somewhat similar scheme. Here the counties were divided into five classes according to the assessed valuation of property in each, the lowest being $500,000 and the highest, $3,250,000. A maximum and a minimum salary for the several county officers of each class was fixed by law; and provision was made that the fees collected by each, with the exception of those of justices of the peace, should be accounted for and paid into the county treasury. Montana has divided the counties into eight classes, and adopted provisions similar to those already mentioned. Nevada in 1885 fixed by law the salaries of some of the county officers and provided that all fees should be paid into the county treasury. Arizona has still another system. Here the counties are classified according to the number of registered voters in each. Officers in those counties having less than 750 voters receive fees and salary which together shall not amount to more than $600. Counties having less than 1500 voters may remunerate their officers by means of fees and salaries; while officers of counties having more than 1500 voters are, within certain maximum limits, to be allowed the fees of office only. California has a much more elaborate system. An act passed in 1891 divided the counties of the state into fifty-three classes based on population. In the

first class were all counties of over 400,000 inhabitants, while the fifty-third class contained all having less than 2000. The salaries for the county clerks, sheriffs, auditors, recorders, treasurers, tax collectors, assessors, and district attorneys were fixed for each class, and provision made that the fees collected should be paid into the county treasuries. The other officers, — coroners, justices of the peace, constables, and so on — are allowed to receive fees; but it is required that an account be kept, and any excess over the maximum allowed must be paid into the county treasury.

The only one of the older states which has as yet attempted to deal with this question in this way is Kentucky. A law, passed in 1895, fixed certain maximum amounts which might be retained as salaries by the county officers; and provided that all sums received above such amounts should be paid into the treasuries, and heavy penalties were prescribed for false reports by any official. An attempt was made a year earlier to limit the amount which might be retained by city officials out of the fees received.

It would appear as though some one of the above schemes, if thoroughly carried out, would furnish an adequate solution for this grave problem. One thing, however, seems certain; and that is, that the experiments which these Western states are carrying on will be of interest and value to every state in the Union, whatever their result may be. The problem is one which confronts almost every locality, although the abuses are more manifest in some states than in others. Thoughtful men and wise legislators are beginning to take more and more interest in the legislative reforms which are attempted, not only within the Union, but in other countries. If the reforms outlined above should at all meet the expectations of the reformers, it will only be a question of time until the movement will spread over the entire West and even overcome the inertia and conservatism of many Eastern commonwealths. But the reform is bound to come in course of time, even if it is not accomplished by such legislation at a single stroke. It requires no great power of observation to see that a change is gradually going on in every one of the states in the Northwest. One official after another is transferred from the fee to the salaried list. Scarcely

a session of a legislature closes without having accomplished one or more changes in this respect.

25. The Fee System as a Social Force. — Some of the important social effects of our fee system are thus described by Professor Urdahl:[1]

1. *The fee system and the tramp question.* — Tramp life is made possible and even agreeable by private charity and alms, or by state aid and relief. A great deal has been said, and a great stress has been laid, upon the evils of indiscriminate charity and outdoor relief, while scarcely a voice is heard against the direct premium placed upon vagrancy, as a result of the use of the fee system to remunerate certain public officers. The average tramp would be forced either to work or to starvation if he could find no comfortable or convenient county jail in which to spend the long cold winter. Under existing conditions, however, he is often a welcome visitor at these public lodging houses; for both the jailer and sheriff are financially better off for each extra "knight of the road" whom they can induce to accept their hospitality, because the county pays the bill at so much per head, and the larger the number, the greater the profits for the keeper.[2] What wonder that some of our county jails are known far and wide among the vagrant classes for their accommodations! Is it surprising that instances repeatedly occur, where the tramp commits some misdemeanor before the very eyes of the sheriff or constable, with the express purpose of securing a commitment to jail for a period of time?

Counties using this system find the number of tramps increasing year after year, in spite of the fact that the jail or prison is crowded the greater part of the time. This has continued, in many cases, until the expense of maintaining tramps has become unbearable, and a demand is made for a new system. As a result the jailer and sheriff, or both, are given a fixed allowance out of which to feed and support all prisoners,[3] and a certain amount of labor is required of these to relieve the monotony.

[1] The Fee System in the United States, 211–230.

[2] Tramps are often furnished with liquor, tobacco, and newspapers, to induce them to return.

[3] This system is now in force in several counties in Wisconsin.

The conditions become changed. The sheriff is no longer interested in having as large a number of tramps as possible within his county. Life within the prison walls is made less attractive; and as a result the stream of vagrants takes another route, through more hospitable districts. A change like the one above described took place in Dane county, Wisconsin; and in four years the cost of maintaining tramps was reduced from $15,000 to $3000. This amount represents the taxes annually levied and actually paid by the public in a single county to support the tramp during that season of the year in which he cannot depend on private charity. In one sense it may be looked upon as a standing bribe to encourage shiftlessness, in the same way that the poor laws of the last century put pauperism at a premium in England.[1]

The jailer and keeper are not the only public officers who are interested in the existence and presence of the tramps. Where the fee system is fully applied, we find every judicial officer more or less interested in having as many tramps brought up for trial as possible. It means, as a rule, a fee for the judge, a fee for the sheriff,[2] and a fee for every other officer who takes part in the trial. It is but natural that inducements should be made for the vagrant to return and be rearrested,[3] to be perhaps again committed to jail for a short time. Indeed, to such an extent have these frauds been carried, that it has been found necessary in some states[4] to pass laws prescribing heavy penalties for conspiracy between tramps and judicial officers[5] to defraud the counties.[6]

[1] A member of the Wisconsin State Board of Charities estimates that the tramps, through the fee system, cost the state over a quarter of a million dollars a year.

[2] The fees of the sheriff for each tramp are said to run from four to six dollars, while those of the judge vary from two to three dollars.

[3] Tramps are often induced to appear before the justice in the forenoon under one name and in the afternoon under another, so as to earn extra fees for each official.

[4] Laws of Wisconsin, 1889.

[5] Some cases have been found where the same tramp was serving three different terms at one time, by being discharged and rearrested and recommitted to jail, so as to earn fees for the sheriff and magistrate.

[6] This state of affairs is not confined to a few states. Inquiries in the different states show that the same frauds have been, or are at present, prevalent in New York, in New England, in the South, in the Middle states, and in the far West.

2. *Fees in police courts and crime.* — Until quite recently both the police force and the municipal courts in most of our large cities were supported more or less by fees and fines, under the mistaken idea that the main function of police officers was to catch criminals, and the function of courts was to pronounce sentence on them when caught. It was also supposed that these public officials would perform their duties more efficiently if impelled by self-interest. This conclusion seems reasonable enough at first blush, but the trouble is that it is based on absolutely false premises. The great and primary function of a police officer is not the apprehension of criminals, but the repression of crime. Paying a police officer according to the number of arrests made is about like paying a teacher according to the number of floggings he has inflicted.

Not only that, but we have a large body of men whose bread and butter depends on having the law violated, although they are themselves its ministers. The idea never seems to have occurred that there was any danger of overofficiousness on the part of any official. The more criminals caught, the better, it is said. True! — but have we any guarantee that the policeman will catch only actual criminals? What is to prevent him from making arrests on slight suspicions, or for trifling and unwarrantable reasons? The same self-interest impels him in the latter as in the former case. As a rule, hungry men are not overscrupulous about the means and methods which will secure them bread. There is every reason to believe that they would sacrifice their most important function, that is, that of repression, to the more profitable employment of making arrests. Indeed, this is amply illustrated by the experience of every city which has changed from fee-paid policemen to salaried officers. An act of the Maryland legislature abolished the fee system in Baltimore in 1862, and as a result the number of arrests for minor offenses decreased from twelve to seven thousand. The decrease in the number of arrests did not result in more lawlessness or more petty offenses, but can be accounted for by the fewer uncalled-for and unnecessary arrests.

3. *Fees and justices of the peace.* — There is, perhaps, no part of the American judicial system which exists with such uniformity in all states as the justice of the peace. And every-

where, almost without exception, his remuneration consists in the fees which he collects. This official seems almost indispensable to the local administration of justice, and no state has as yet been able to devise any fair and economical system of compensation other than fees.

The amount of business done by each of these officials varies from time to time and place to place. One justice may have regular daily sessions, while another is scarcely ever called upon to act. All cannot be paid salaries, as it would entail enormous expense to the public; and apparently such a system would be unjust to the magistrate who is called upon to act often. To the casual observer, it would seem, therefore, as though some well-devised scale of fees would be the only just and fair method of remuneration. But a closer investigation will reveal the fact, that other things must be taken into consideration besides the interest of the justice of the peace and the economy of public money. There is such a thing as a "penny wise and pound foolish" policy in public as well as in private economics.

Perhaps no single influence has done more injury through the American courts than the fee system in its effects on the justice of the peace. The men who occupy this position are not as a rule of such a character that they can stand by and unconcernedly see all cases, and in consequence all fees connected with them, go to the rival or neighboring justice. As a rule, they are not men of means, and a fee more or less is of great importance. What is the result? The result is that the decision of a justice of the peace is almost certain to be a discrimination in favor of the plaintiff. Why? Because it is the plaintiff who begins the suit, and he or his lawyer has the option of bringing the case in Justice A's or Justice B's or any other court. If he brings it into Justice A's court, it means a certain number of fees for him, and he must therefore show his gratitude by rendering his judgment for the plaintiff. But suppose the justice has the moral courage to decide the case on its merits, and that as a result his decision is in favor of the defendant. The consequence is that Justice A will receive no more patronage from that lawyer or plaintiff. All the cases, and hence all the fees, which he might have had, are therefore transferred to Justice B, who is more grateful.

These cases are not pure assumptions. They are actual facts which are known and utilized every day by lawyers throughout the land. The many upright and conscientious justices, whose characters are above reproach, are prevented from exerting even the average amount of influence by the vicious system, which from its very nature drives the business into the courts of these disreputable wretches who are willing to barter their judgment for a paltry fee. The system becomes in its essence, in many cases, a legalized method of bribery. The whole administration of justice is perverted in that large class of cases in which the humbler classes of the community are most likely to be affected. Such a system would not be tolerated in the higher courts, while here it is continued year after year without protest, because the cases affected, as a rule, are petty and insignificant in regard to the amount involved.

4. *Fees of the district attorney and the administration of justice.* — One of the relics of barbarism which exists in some states or, perhaps more accurately, one of the barbarous inventions of the nineteenth century, is the system of paying district or state attorneys fees, varying in amount according to the number and character of the convictions secured. This method is not based on the experience of any state, but is like so many other unpractical schemes which are adopted and applied in many Western commonwealths. To be sure, there have been laws in some of the original states which are somewhat similar and may be called antecedents of these. But the differences are broad and far-reaching. A Connecticut statute of 1796 provided that the state attorney should receive fees roughly proportioned to the nature of the trial.[1] For prosecuting a trial for a capital offense he secured $14, for any other criminal case $9, and for any civil case $3.34. This, however, is widely different from the system now in force in California, which pays the attorney $50 for every conviction he secures for a capital offense, $25 for each conviction of felony, and $15 for misdemeanor; and, with the object apparently of especially punishing gambling, the same premium is placed on conviction under the act prohibiting gaming as for a capital offense.

[1] An early law of Delaware gave the attorney-general $10 for the prosecution of a capital offense and $2.40 for drawing an indictment, etc.

In Arkansas the prosecuting attorney receives $75 for a conviction of a capital offense, $25 for felony, $25 for gambling, and $10 for each misdemeanor. In Tennessee the district attorney receives $50 for each conviction for violation of the anti-trust law; while for obtaining a conviction for murder or wearing bowie-knife or violating the law against conspiracies, the fee is $25; for a conviction for perjury, $15; felony, $10; and misdemeanor, $5. In Nevada the fees are relatively the same, but five times as large. In Oregon there is another departure. Here the attorney receives certain fixed fees for convictions, and in case the trial results in acquittal he receives only half the amount.

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All of these methods are fundamentally wrong, and based on a theory which cannot be supported either by facts or by arguments. It is supposed to increase the efficiency of the attorney by offering him a pecuniary inducement to undertake and prosecute cases. But is there not every legitimate incentive to an attorney to do his work well, even when he is paid by salary? His reputation as a lawyer is at stake; the esteem and good-will of his constituents impel him to prosecute every legitimate case. His success as a lawyer after his term of office expires will depend largely on the way in which he performs his duties of office. He can gain nothing by letting crime go unpunished, and he has everything to lose.

But suppose that the man is of such a character that the paltry fee will stimulate him to action. If it is only the money he is after, what is to prevent him from accepting a higher reward from the criminal for not prosecuting than the state offers for conviction? What is to prevent him from "drumming up" business by beginning suits wherever there is the slightest chance of winning?

5. *The fee system and political corruption.* — Very few people are so ignorant of politics as not to have heard, from rumor at least, of public offices the emoluments of which are so great as to enrich the occupant in a single year. No public office in the gift of the people is of such importance as to yield a regular legal salary of $100,000, even though it requires the highest grade of ability which the country can furnish. This amount

has been received more than once, however, by officers whose duties and abilities were of a comparatively low order. The position of sheriff in a densely populated county, or that of recorder or collector, are offices which do not require a very high grade of attainments; and yet these purely clerical officers have often been paid a higher salary than the President of the United States. Some of these are reported to yield fabulous sums;[1] yet no actual facts can be ascertained as to the real value of such offices, as they are usually kept a close secret among a favored few of the leading politicians of either party. Very often no account of the receipts of office is required by law; hence none is given.

These positions are usually the goal of the ambition of every politician. There is, therefore, the most intense competition, not only within the political parties for obtaining the nominations, but among the people to secure election when once nominated. These lucrative offices furnish the lifeblood of the spoils system and the political machine. The manipulators of the machine, knowing the value of such an office, can levy higher assessments for the corruption fund the greater the amount received from the office. Especially is this the case where a political party practically controls the election. It does not require any great power of observation to see that in all local or state elections, the heaviest pressure is, as a rule, brought to bear on those particular offices in which the remuneration is wholly or partly paid in fees or other perquisites. It is the office of county sheriff in most places which is the center of the political whirlpool. In many Eastern cities the office of prothonotary, clerk of court, or recorder is the most powerful incentive to political activity.[2] The political forces which are set in motion to obtain

[1] The income of the city clerk of Chicago was asserted to be $49,000 for two years. Chicago *Times-Herald*, Jan. 16, 1896, p. 1. The Chicago recorder's income was estimated by an investigating committee to have been nearly $9000 for six months. *Ibid.* Dec. 7, 1896, p. 7. The position of county sheriff in many counties in Wisconsin is said to yield as much as $20,000 a year. Many county clerks earn over $5000 a year in fees. Newspaper reports are current that the collector of taxes under Governor Warmouth at New Orleans received as fees not less than $100,000 a year, for four years.

[2] A prominent New York attorney has furnished the following estimates which are said to be conservative: The position of sheriff of New York county used to yield

these lucrative positions are almost incredible in power and magnitude. Each candidate has a whole army of henchmen in the field, each of these demanding pay either by some position or by money. How is all this possible? Most of these positions have no great amount of honor connected with them or even of influence, except so far as the subordinate appointments are concerned. The mainspring which furnishes the power for all this political machinery lies in the amount of salary which the fees yield to the officer. He can afford to spend $50,000 in money and a year or two of his time to obtain an office that will yield $100,000 a year in revenue. A man can afford to contribute liberally to the party fund who can realize such a sum if his party succeeds. Political office is not the greatest incentive or stimulus which he has. More is at stake. The candidate has usually invested his entire fortune on the issue, often also as much as he can borrow from his friends. Is it any wonder that he strains every nerve to win? Is it surprising that no stone is left unturned which will aid his election? Success means not only a position for a year or two, but it means comparative wealth and prosperity affecting his entire career, and opens the door to future advancement. It is almost in the nature of a wager in which everything is at stake. Under such conditions more or less corruption is inevitable; and the worst of it is, that the people themselves pay the fees which constitute the corruption fund. The history of any of our large cities will furnish numerous examples, and there is scarcely a county in the older states in which the same spectacle has not been witnessed over and over again.

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The only remedy is to enforce the most rigid system of accountability, so that every fee collected is paid into the treasury. It is bad business management to allow an official to pay and appoint his own clerks. No private enterprise could exist for any length of time which employed such methods. A private establishment always pays its subordinates from the general treasury, and keeps a sharp watch over their salaries

$125,000; at present it yields about $25,000. The position of county clerk in New York City used to yield from $80,000 to $100,000; at present it is considered to be worth $25,000. The office of register of deeds is at present worth about $20,000.

and efficiency. The same economy must be applied to public affairs if they are to be well administered.[1] All the corruption is not, as a rule, caused by bad legislation; the laws creating the various offices and making provisions for their emoluments were legitimate and proper at the time when they were enacted. But most of them were enacted very early in the history of the country, and few, if any, radical changes have been made in them. But they have simply outlived their period of usefulness. Economic conditions have changed, while the laws have not been changed to fit them. The fee bill, which would yield barely enough revenue to support the sheriff of New York in 1840, would, if in force in 1890, produce a fortune in a single year. Why? Simply because the business of the office has increased enormously on account of the growth of population. Furthermore, the work can be done at a much lower cost. It is like production on a large scale, in that economies of various kinds can be practiced.

The question immediately arises: Why have the legislatures so often failed to adjust law to economic conditions in this particular more than in others? The answer is evident. Whichever political party happens to be in power is directly interested in having as many lucrative offices to bestow as possible. A party is not likely to diminish the emoluments of an office when, by so doing, it diminishes to just that extent the patronage

[1] Elsewhere (p. 189) Professor Urdahl says: "Scarcely any of the states employing the fee system have as yet required the officers to give any strict account of the total amount received as fees. Even if the new system is introduced, it becomes next to impossible to obtain any figures which will show in dollars and cents the total gain or loss due to the one system or the other. It is quite different with the federal officials, and more especially those connected with the federal courts. These were required comparatively early to give a complete account of every fee received. We have thus full and reliable statistics of the amounts collected as fees in the various courts for a long series of years. These figures show that the cost of maintaining the United States courts has for a number of years been increasing at the rate of over a million dollars a year. On May 28, 1896, Congress passed an act which changed most of the officials connected with the federal courts from the fee to the salary system of compensation. The result is, that the total expenses under the new system for the current year 1897, according to the estimates made by the attorney-general, based on the returns for the first six months, will be $4,861,465, as compared with $6,675,239 for 1896, which was the cost under the fee system. This shows a total saving of $1,813,774 in spite of the fact that the volume of business is on the increase."

which it has to confer. Especially is this the case where no pressure in that direction is brought to bear upon the legislative body. There is likely to be no pressure of this kind for the diminution of the fees of an office or a change in the system, because no body of individuals, as a class, is likely to be especially affected or feel the burden of the system. The fees are paid intermittently, now by one person and now by another; while the great majority of people rarely have any fees to pay at all. There has thus never arisen any popular demand for the publication of the amount of fees collected or for their reduction. As a result, we find that it is only at this late day that the same requirements are beginning to be made in regard to fees as were introduced in regard to taxes one hundred years ago; namely, that their amount should be made public, and that all fees collected should be accounted for. This lack of knowledge of the number of fees collected has tended still further to discourage any agitation for their reduction. But whenever a movement of this kind is started, then all the fee-collecting officers, with all the political influence which they can command, stand ready to work against it.[1] It is not strange, therefore, when everything is taken into consideration, that primitive laws have so long remained in force, and that they are even now with difficulty being displaced with more modern and suitable enactments. The movement seems to be in progress which appears destined to place every fee-paid public officer on a salary or what is equivalent to the same. This, together with civil service reform, will ultimately remove the greater part of the political corruption connected with purely administrative offices. But from the very nature of American conditions, the movement must be slow and gradual.

[1] A bill to abolish some minor sheriffs' fees in the Wisconsin legislature in 1896 was defeated through the lobbying of the sheriffs and their friends. Numerous similar bills have met the same fate. It is a notorious fact, well known to all who are familiar with New York politics, that the recent amendment to the New York fee code failed to pass because of the opposition of sheriffs and other fee-paid officials, whose salaries would have been affected thereby.

CHAPTER VIII

GENERAL PROPOSITIONS CONCERNING TAXATION

26. Smith's Canons of Taxation. — Few passages in the literature of finance are more celebrated than those with which Adam Smith introduces his discussion of taxation. Smith said:[1]

The private revenue of individuals, it has been shown in the first book of this inquiry, arises ultimately from three different sources: rent, profit, and wages. Every tax must finally be paid from some one or other of those three different sorts of revenue, or from all of them indifferently. I shall endeavor to give the best account I can, first, of those taxes which it is intended should fall upon rent; secondly, of those which it is intended should fall upon profit; thirdly, of those which it is intended should fall upon wages; and fourthly, of those which it is intended should fall indifferently upon all those three different sources of private revenue. The particular consideration of each of these four different sorts of taxes will divide the second part of the present chapter into four articles, three of which will require several other subdivisions. Many of those taxes, it will appear from the following review, are not finally paid from the fund or source of revenue, upon which it was intended they should fall.

Before I enter upon the examination of particular taxes, it is necessary to premise the four following maxims with regard to taxes in general.

1. The subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of

[1] Wealth of Nations, Bk. V, ch. 2.

the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed, once for all, which falls finally upon one only of the three sorts of revenue above mentioned, is necessarily unequal, in so far as it does not affect the other two. In the following examination of different taxes I shall seldom take much further notice of this sort of inequality, but shall, in most cases, confine my observations to that inequality, which is occasioned by a particular tax falling unequally even upon that particular sort of private revenue which is affected by it.

2. The tax which each individual is bound to pay, ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the taxgatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favors the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay, or when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury, are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them by

little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconveniency from such taxes.

4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another additional tax upon the people. Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so. Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment, too, in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime. Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it. It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign.

The evident justice and utility of the foregoing maxims have

recommended them more or less to the attention of all nations. All nations have endeavored, to the best of their judgment, to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both in the time and in the mode of payment, and, in proportion to the revenue which they brought to the prince, as little burdensome to the people. The following short review of some of the principal taxes which have taken place in different ages and countries will show that the endeavors of all nations have not in this respect been equally successful.

27. The General Economic Effect of Taxation. — In his Essay on Taxes,[1] David Hume remarked:

There is a prevailing maxim,[2] among some reasoners, *that every new tax creates a new ability in the subject to bear it, and that each increase of public burdens increases proportionably the industry of the people.* This maxim is of such a nature as is most likely to be abused; and is so much the more dangerous, as its truth cannot be altogether denied: but it must be owned, when kept within certain bounds, to have some foundation in reason and experience.

When a tax is laid upon commodities which are consumed by the common people, the necessary consequence may seem to be, either that the poor must retrench something from their way of living, or raise their wages, so as to make the burden of the tax fall entirely upon the rich. But there is a third consequence, which often falls upon taxes; namely, that the poor increase their industry, perform more work, and live as well as before, without demanding more for their labor. Where taxes are moderate, are laid on gradually, and affect not the necessaries of life, this consequence naturally follows; and it is certain, that such difficulties often serve to excite the industries of a people, and render them more opulent and laborious than others, who enjoy the greatest advantages.

[1] Political Essays (1752).

[2] During the seventeenth and eighteenth centuries many writers in England argued that taxes have a tendency to stimulate industry and frugality. See Seligman, Shifting and Incidence of Taxation, 32–39. — Ed.

A similar opinion was expressed by J. R. McCulloch nearly a century later:[1]

The writers on finance, patronized by European governments, have mostly labored to show that taxation is never a cause of diminished production; but that, on the contrary, every new tax creates a new ability in the subject to bear it, and every increase of the public burdens a proportional increase in the industry of the people. The fallacy of this opinion, when advanced thus absolutely and without reservation, has been ably exposed by Hume in his Essay on Taxes. But, as already seen, it is undoubtedly true that the desire to maintain and improve their condition stimulates most men to endeavor to discharge the burden of additional taxes by increased industry and economy, without allowing them to encroach on their means of subsistence, or on their fortunes.

The operation of this principle has been strikingly evinced in the financial history of this country since the commencement of the American war. That contest, and the more recent struggle with revolutionary France, occasioned a vast increase of taxation, and an expenditure that has no parallel in the history of the world. The public debt which amounted to about 129 millions in 1775, amounted to about 848 millions in 1817; and, in addition to the immense sums raised by borrowing, the gross produce of the taxes levied in the United Kingdom during the late war exceeded the enormous sum of 1100 millions sterling. And yet the rapid increase of population — the wonderful progress and improvement of agriculture, manufactures, and commerce — the extension and embellishment of towns and cities — the formation of so many new docks, roads, and canals — and the infinite variety of expensive undertakings entered upon and completed in all parts of the country during the continuance of hostilities — show clearly that the savings of the mass of the people greatly exceeded the warlike expenditure of government and the unprofitable expenditure of individuals.

* * * * * * *

The constantly increasing pressure of taxation during the war, begun in 1793, was felt by all classes, and gave a spur to industry,

[1] Treatise on Taxation, 7–10 (second edition, 1852).

enterprise, and invention, and generated a spirit of economy which we should have in vain attempted to excite by any less powerful means. Had taxation been very oppressive, it would not have had this effect; but it was not so high as to produce either dejection or despair, though it was at the same time sufficiently heavy to render a very considerable increase of industry and parsimony necessary to prevent it from encroaching on the fortunes of individuals, or, at all events, from diminishing the rate at which they had previously been increasing. Man is not influenced solely by hope, he is also powerfully influenced by fear. Taxation brings the latter principle into the field. To the desire of rising in the world, implanted in the breast of every individual, an increase of taxation superadds the fear of being cast down to a lower station, of being deprived of conveniences and gratifications which habit has rendered all but indispensable; and the combined influence of the two principles produces results that could not be produced by the unassisted agency of either. Without the American war and the late French war there would have been less industry and less frugality, because there would have been less occasion for them. And we incline to think that those who inquire dispassionately into the matter will most probably see reason to conclude that the increase of industry and frugality occasioned by these contests more than sufficed to defray their enormous expense, and that the capital of the country is probably about as great at this moment as it would have been had they not occurred.

But we must be on our guard against the abuse of this doctrine, and must not suppose that, because it holds in certain cases and under certain conditions, it will, therefore, hold in all cases and under all conditions. To render an increase of taxation productive of greater exertion, economy, and invention, it should be slow and gradual; and it should never be carried to such a height as to incapacitate individuals from meeting the sacrifices it imposes by such additional exertions and savings as it may be in their power to make without requiring any very sudden or violent change in their habits. The increase of taxation should never be so great as to make it impracticable to overcome its influence, or to induce the belief that it is impracticable. Difficulties that are seen to be surmountable sharpen the inventive powers, and

are readily and vigorously grappled with; but an apparently insurmountable difficulty, or such an increase of taxation as it was deemed impossible to defray, would not stimulate but destroy exertion. Whenever taxation becomes so heavy that the wealth it takes from individuals can no longer be replaced by fresh efforts, these efforts uniformly ceased to be made; industry is paralyzed, and the country declines. Oppression, it has been said, either raises men into heroes or sinks them into slaves; and taxation, according to its magnitude and the mode in which it is imposed, either makes men industrious, enterprising, and wealthy, or indolent, dispirited, and impoverished.

And elsewhere in his treatise[1] McCulloch offered the following illustration, which has been repeated by many writers:

It is unnecessary, however, to travel beyond the limits of financial history for examples of the powerful influence of taxes in stimulating ingenuity and invention. Previously to 1786 the duties on spirits distilled in Scotland were charged according to the quantities supposed to be actually produced. But as this mode of assessing the duty was found to open a door to extensive frauds, it was resolved to substitute in its stead a license duty, proportioned to the size of the still used by the distiller. Stills being all of the same shape, and the quantity of spirits that each could produce in a year according to its cubic contents having been accurately calculated, it was supposed that this plan would effectually prevent smuggling, and that the officers would have nothing to do but inspect the stills that had been licensed, to prevent their size being increased. On the first introduction of this apparently well-considered system, the license duty on each still was fixed at the rate of 30*s.* per gallon of its contents. The principle, however, on which the duty was assessed was very soon subverted. The stills in use down to this period were very deep in proportion to their diameter, so that after being charged they required at an average about a week before the process of distillation was completed. But the new mode of charging the duty had no sooner been introduced, than it occurred to two ingenious persons, Messrs. John and William

[1] pp. 151–152.

Sligo, distillers, Leith, that by lessening the depth of the still and increasing its diameter, a larger surface would be exposed to the action of the fire, and they would be enabled to run off its contents in considerably less time. Having adopted this plan, they found that it answered their expectations, and that they were able to distil the same quantity of spirits in a few hours that had previously occupied a week. Messrs. Sligo kept this important invention secret for about a year; but it was too valuable to be long concealed, and the moment it transpired, the plan was adopted by other distillers. In consequence government raised, in 1788, the license duty on the still from 30*s.* to £3 a gallon. This increase having redoubled the activity of the distillers, the duty was raised in 1793 to £9 a gallon, in 1795 to £18, and in 1797 it was carried to the enormous sum of £54 a gallon. Still, however, the ingenuity of the distiller outran the increase of the tax; and it was proved, before a committee of the House of Commons in 1798, that distillation had been carried to such perfection, that stills had occasionally been filled and discharged once every *eight* minutes. This, it was supposed, must be the maximum of velocity, and a new license duty was laid on the still on the hypothesis that it could, at an average, be run off in that time, or that it could be filled and emptied once every eight minutes during the season. But the ingenuity of the distillers was not yet tasked to the highest. And it was ascertained that, toward the latter end of the license system, stills of forty gallons had been, at an average, filled and run off in the almost incredibly short space of *three* minutes, being an increase of 2880 times on the rapidity of distillation that had obtained when the license system was introduced in 1786!

Now it will not be alleged, at least with any appearance of probability, that had a duty of 5 or 10 per cent been laid on their income or capital, Messrs. Sligo would have been half so likely to make this important discovery. But being assessed on the still, the duty had the double effect of fixing attention specially on it, and of operating as a powerful incentive to its improvement.[1]

[1] It is important to observe, however, as Bastable has pointed out, that "invention had been stimulated, not by the duty, but by the possibility of escaping it." Thus not the payment of a tax, but the imperfect assessment which left a loophole

28. The Views of Say. — While most economists have been content to emphasize more sharply than Hume and McCulloch did the limitations and possible dangers of the proposition that taxes tend to stimulate industry and thrift, Jean Baptiste Say and a few others have denied that the statement contains the least kernel of truth. Say, for instance, said:[1]

> The same causes that we have found to make unproductive consumption unfavorable to reproduction, prevent taxation from at all promoting it. Taxation deprives a producer of a product which he would otherwise have the option of deriving a personal gratification from, if consumed unproductively, or of turning to profit, if he preferred to devote it to a useful employment. One product is a means of raising another; and, therefore, the subtraction of a product must needs diminish, instead of augmenting, productive power.
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> It may be urged that the pressure of taxation impels the productive classes to redouble their exertions, and thus tends to enlarge the national production. I answer that, in the first place, mere exertion cannot alone produce; there must be capital for it to work upon, and capital is but an accumulation of the very products that taxation takes from the subject: that, in the second place, it is evident, that the values which industry creates expressly to satisfy the demands of taxation, are no increase of wealth; for they are seized on and devoured by taxation. It is a glaring absurdity to pretend that taxation contributes to national wealth, by engrossing part of the national produce; and enriches the nation by consuming part of its wealth. Indeed, it would be trifling with my reader's time to notice such a fallacy, did not most governments act upon this principle, and had not well-intentioned and scientific writers endeavored to support and establish it.
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> If from the circumstance that the nations most grievously taxed are those most abounding in wealth, as Great Britain for example, we are desired to infer, that their superior wealth arises

for escape, was the real cause for the improvement. Bastable, Public Finance, 286. — Ed.

[1] Traité d'économie politique, Bk. III, ch. 8.

from their heavier taxation, it would be a manifest inversion of cause and effect. A man is not rich because he pays largely; but he is able to pay largely, because he is rich. It would be not a little ridiculous, if a man should think to enrich himself by spending largely, because he sees a rich neighbor doing so. It must be clear that the rich man spends because he is rich, but never can enrich himself by the act of spending.

Cause and effect are easily distinguished, when they occur in succession; but are often confounded, when the operation is continuous and simultaneous.

Hence, it is manifest that, although taxation may be, and often is, productive of good, when the sums it absorbs are properly applied, yet, the act of levying is always attended with mischief at the outset. And this mischief good princes and governments have always endeavored to render as inconsiderable to their subjects as possible, by the practice of economy, and by levying, not to the full extent of the people's ability, but to such extent only as is absolutely unavoidable. That rigid economy is the rarest of princely virtues, is owing to the circumstance of the throne being constantly beset with individuals, who are interested in the absence of it; and who are always endeavoring, by the most specious reasoning, to impress the conviction that magnificence is conducive to public prosperity and that profuse public expenditure is beneficial to the state. It is the object of this third book to expose the absurdities of such representations.

29. The Source of Taxation. — Adam Smith declared that taxes are generally paid out of "the revenue of private people" and do not ordinarily occasion "the destruction of any actually existing capital." Loans, however, he believed to be raised out of the previously accumulated wealth of society so that they are derived from capital and not from revenue.[1] From this suggestion David Ricardo, a generation later, developed his elaborate argument that income, or revenue, should be the normal source of taxation. He said:[2]

[1] Wealth of Nations, Bk. V, ch. 3.

[2] Principles of Political Economy and Taxation, ch. 8 (1817).

Taxes are a portion of the produce of the land and labor of a country, placed at the disposal of the government; and are always ultimately paid, either from the capital, or from the revenue of the country.

We have already shown how the capital of a country is either fixed or circulating, according as it is of a more or less durable nature. It is difficult to define strictly, where the distinction between circulating and fixed capital begins; for there are almost infinite degrees in the durability of capital. The food of a country is consumed and reproduced at least once in every year; the clothing of the laborer is probably not consumed and reproduced in less than two years; whilst his house and furniture are calculated to endure for a period of ten or twenty years.

When the annual productions of a country more than replace its annual consumption, it is said to increase its capital; when its annual consumption is not at least replaced by its annual production, it is said to diminish its capital. Capital may therefore be increased by an increased production, or by a diminished unproductive consumption.

If the consumption of the government, when increased by the levy of additional taxes, be met either by an increased production, or by a diminished consumption on the part of the people, the taxes will fall upon revenue, and the national capital will remain unimpaired; but if there be no increased production or diminished unproductive consumption on the part of the people, the taxes will necessarily fall on capital; that is to say, they will impair the fund allotted to productive consumption.[1]

In proportion as the capital of a country is diminished, its productions will be necessarily diminished; and, therefore, if the same unproductive expenditure on the part of the people

[1] It must be understood that all the productions of a country are consumed; but it makes the greatest difference imaginable whether they are consumed by those who reproduce, or by those who do not reproduce another value. When we say that revenue is saved, and added to capital, what we mean is, that the portion of revenue, so said to be added to capital, is consumed by productive instead of unproductive laborers. There can be no greater error than in supposing that capital is increased by non-consumption. If the price of labor should rise so high, that notwithstanding the increase of capital, no more could be employed, I should say that such increase of capital would be still unproductively consumed.

and of the government continue, with a constantly diminishing annual reproduction, the resources of the people and of the state will fall away with increasing rapidity, and distress and ruin will follow.

Notwithstanding the immense expenditure of the English government during the last twenty years,[1] there can be little doubt but that the increased production on the part of the people has more than compensated for it. The national capital has not merely been unimpaired, it has been greatly increased, and the annual revenue of the people, even after the payment of their taxes, is probably greater at the present time than at any former period of our history.

For the proof of this we might refer to the increase of population — to the extension of agriculture — to the increase of shipping and manufactures — to the building of docks — to the opening of numerous canals, as well as to many other expensive undertakings; all denoting an increase both of capital and of annual production.

Still, however, it is certain that but for taxation this increase of capital would have been much greater. There are no taxes which have not a tendency to lessen the power to accumulate. If they encroach on capital, they must proportionably diminish that fund by whose extent the extent of the productive industry of the country must always be regulated; and if they fall on revenue, they must either lessen accumulation, or force the contributors to save the amount of the tax, by making a corresponding diminution of their former unproductive consumption of the necessaries and luxuries of life. Some taxes will produce these effects in a much greater degree than others; but the great evil of taxation is to be found, not so much in any selection of its objects, as in the general amount of its effects taken collectively.

Taxes are not necessarily taxes on capital, because they are laid on capital; nor on income, because they are laid on income. If from my income of £1000 per annum, I am required to pay £100, it will really be a tax on my income, should I be content with the expenditure of the remaining £900; but it will be a tax on capital, if I continue to spend £1000.

The capital from which my income of £1000 is derived may

[1] (1793–1815.)

be of the value of £10,000; a tax of one per cent on such capital would be £100; but my capital would be unaffected, if after paying this tax, I in like manner contented myself with the expenditure of £900.

The desire which every man has to keep his station in life, and to maintain his wealth at the height which it has once attained, occasions most taxes, whether laid on capital or on income, to be paid from income; and therefore as taxation proceeds, or as government increases its expenditure, the annual enjoyments of the people must be diminished, unless they are enabled proportionally to increase their capitals and income.

It should be the policy of governments to encourage a disposition to do this in the people, and never to lay such taxes as will inevitably fall on capital; since by so doing, they impair the funds for the maintenance of labor, and thereby diminish the future production of the country.

In England this policy has been neglected, in taxing the probates of wills, in the legacy duty, and in all taxes affecting the transference of property from the dead to the living. If a legacy of £1000 be subject to a tax of £100, the legatee considers his legacy as only £900 and feels no particular motive to save the £100 duty from his expenditure, and thus the capital of the country is diminished; but if he had really received £1000, and had been required to pay £100 as a tax on income, on wine, on horses, or on servants, he would probably have diminished, or rather not increased his expenditure by that sum, and the capital of the country would have been unimpaired.

In 1848 John Stuart Mill criticised Ricardo's doctrine at several points.[1] He said:[2]

In addition to the preceding rules, another general rule of taxation is sometimes laid down, namely, that it should fall on income, and not on capital. That taxation should not encroach upon the amount of the national capital, is indeed of the greatest importance; but this encroachment, when it occurs, is not so much a consequence of any particular mode of taxation, as

[1] In a subsequent chapter (sec. 77) a further criticism of Smith and Ricardo is presented.

[2] Principles of Political Economy, Bk. V, ch. 2, § 7.

of its excessive amount. Overtaxation, carried to a sufficient extent, is quite capable of ruining the most industrious community, especially when it is in any degree arbitrary, so that the payer is never certain how much or how little he shall be allowed to keep; or when it is so laid on as to render industry and economy a bad calculation. But if these errors be avoided, and the amount of taxation be not greater than it is at present, even in the most heavily taxed country of Europe, there is no danger lest it should deprive the country of a portion of its capital.

To provide that taxation shall fall entirely on income, and not at all on capital, is beyond the power of any system of fiscal arrangements. There is no tax which is not partly paid from what would otherwise have been saved; no tax, the amount of which, if remitted, would be wholly employed in increased expenditure, and no part whatever laid by as an addition to capital. All taxes, therefore, are in some sense partly paid out of capital; and in a poor country it is impossible to impose any tax which will not impede the increase of the national wealth. But in a country where capital abounds, and the spirit of accumulation is strong, this effect of taxation is scarcely felt. Capital having reached the stage in which, were it not for a perpetual succession of improvements in production, any further increase would soon be stopped — and having so strong a tendency even to outrun those improvements, that profits are only kept above the minimum by emigration of capital, or by a periodical sweep called a commercial crisis; to take from capital by taxation what emigration would remove, or a commercial crisis destroy, is only to do what either of those causes would have done, namely, to make a clear space for further saving.

I cannot, therefore, attach any importance, in a wealthy country, to the objection made against taxes on legacies and inheritances, that they are taxes on capital. It is perfectly true that they are so. As Ricardo observes, if £100 are taken from any one in a tax on houses or on wine, he will probably save it, or a part of it, by living in a cheaper house, consuming less wine, or retrenching from some other of his expenses: but if the same sum be taken from him because he has received a legacy of £1000, he considers the legacy as only £900, and feels no more inducement than at any other time (probably feels

rather less inducement) to economize in his expenditure. The tax, therefore, is wholly paid out of capital: and there are countries in which this would be a serious objection. But in the first place, the argument cannot apply to any country which has a national debt, and devotes any portion of revenue to paying it off; since the produce of the tax, thus applied, still remains capital, and is merely transferred from the taxpayer to the fundholder. But the objection is never applicable in a country which increases rapidly in wealth. The amount which would be derived, even from a very high legacy duty, in each year, is but a small fraction of the annual increase of capital in such a country; and its abstraction would but make room for saving to an equivalent amount: while the effect of not taking it, is to prevent that amount of saving, or cause the savings, when made, to be sent abroad for investment. A country which, like England, accumulates capital not only for itself but for half the world, may be said to defray the whole of its public expenses from its overflowings; and its wealth is at this moment as great as if it had no taxes at all. What its taxes really do is, to subtract from its means, not of production but of enjoyment; since whatever any one pays in taxes, he could, if it were not taken for that purpose, employ in indulging his ease, or in gratifying some want or taste which at present remains unsatisfied.

CHAPTER IX

JUSTICE IN TAXATION: PROPORTIONAL *VS.* PROGRESSIVE TAXATION

30. The Views of Say and McCulloch. — Adam Smith, it will be remembered, had laid it down, as the first canon of taxation, that the "subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation." His successors carried on a lively debate as to what constitutes equality, and, particularly, whether a progressive or proportional rate of taxation corresponds most nearly to the demands of justice. Jean Baptiste Say, for instance, argued for progressive rates of taxation. He said: [1]

> Taxation, being a burden, must needs weigh lightest on each individual when it bears upon all alike. When it presses inequitably upon one individual or branch of industry, it is an indirect, as well as a direct, incumbrance; for it prevents the particular branch or the individual from competing on even terms with the rest. An exemption, granted to one manufacture, has often been the ruin of several others. Favor to one is most commonly injustice to all others.
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> The partial assessment of taxation is no less prejudicial to the public revenue than unjust to individual interests. Those who are too lightly taxed are not likely to cry out for an increase; and those who are too heavily taxed are seldom regular in their payments. The public revenue suffers in both ways.

[1] Traité d'économie politique, Bk. III, ch. 8.

It has been questioned whether it be just to tax that portion of revenues which is spent on luxuries more heavily than that spent on objects of necessity. It seems but reasonable to do so; for taxation is a sacrifice to the preservation of society and of social organization, which ought not to be purchased by the destruction of individuals. Yet the privation of absolute necessaries implies the extinction of existence. It would be somewhat bold to maintain, that a parent is bound in justice to stint the food or clothing of his child to furnish his contingent to the ostentatious splendor of a court or the needless magnificence of public edifices. Where is the benefit of social institutions to an individual whom they rob of an object of positive enjoyment or necessity in actual possession, and offer nothing in return but the participation in a remote and contingent good which any man in his senses would reject with disdain?

But how is the line to be drawn between necessaries and superfluities? In this discrimination there is the greatest difficulty; for the terms, necessaries and superfluities, convey no determinate or absolute notion, but always have reference to the time, the place, the age, and the condition of the party; so that, were it laid down as a general rule, to tax none but superfluities, there would be no knowing where to begin and where to stop. All that we certainly know is, that the income of a person or a family may be so confined as barely to suffice for existence; and may be augmented from that minimum upward by imperceptible gradation, until it embrace every gratification of sense, of luxury, or of vanity; each successive gratification being one step further removed from the limits of strict necessity, until at last the extreme of frivolity and caprice is arrived at; so that, if it be desired to tax individual income, in such manner as to press lighter in proportion as that income approaches to the confines of bare necessity, taxation must not only be equitably apportioned, but must press on revenue with progressive gravity.

In fact, supposing taxation to be exactly proportionate to individual income, — a tax, let us say, of 10 per cent, — a family possessed of 300,000 francs per annum would pay 30,000 francs in taxes, leaving a clear residue of 270,000 francs for the family expenditure. With such an expenditure, the family could not

only live in abundance, but could still enjoy a vast number of gratifications by no means essential to happiness. Whereas another family, with an income of 300 francs, reduced by taxation to 270 francs per annum, would, with our present habits of life and ways of thinking, be stinted in the bare necessaries of subsistence. Thus a tax merely proportionate to individual income would be far from equitable; and this is probably what Smith meant, by declaring it reasonable, that the rich man should contribute to the public expenses not merely in proportion to the amount of his revenue, but even somewhat more. For my part, I have no hesitation in going further, and saying that taxation cannot be equitable unless its ratio is progressive.

Upon the other hand, John Ramsay McCulloch contended vigorously for proportional taxation, and was inclined to minimize the importance of considerations of abstract justice in matters of taxation. McCulloch wrote: [1]

There can be no doubt that, were it practicable, the burden of taxation should be made to press on individuals in proportion to their respective revenues. A, with an income of £1000 a year, ought to pay ten times the tax paid by B, who has only £100 a year, and the latter ten times as much as C, who has only a pittance of £10.[2] The state has been ingeniously compared by M. Thiers to a mutual insurance company, where the payments by the members are exactly proportioned to the sums they have insured, or to their interests in the company. And so it should be with the subjects of government. It is established for the common benefit of all — of those who labor with the hand, and of those who labor with the head; of those to whom property has descended, and of those by whom it has been acquired; and is alike indispensable to their well-being and prosperity. And being so, it necessarily follows that every individual should contribute to its support according to his stake in the society, or to his means. This is a plain as well as a sound rule; and it is one that should never be forgotten or overlooked.

[1] Treatise on Taxation, 17–21 (second edition).

[2] It is, perhaps, needless to say that the incomes of the different parties are supposed to be perpetual, or of the same duration.

Practically, however, it is not possible to attain to anything like a perfect equality of taxation; and provided no tax be imposed in the view of trenching on this principle, or of making one class or order of people pay more in proportion to their means than others, the equality of taxation is of less importance. In this, as in most other departments of politics, we have only a choice of difficulties; and what is absolutely right must often give way to what is expedient and practicable. It is the business of the legislator to look at the practical influence of different taxes, and to resort in preference to those by which the revenue may be raised with the smallest inconvenience. Should the taxes least adverse to the public interests fall on the contributors according to their respective abilities, it will be an additional recommendation in their favor. But the *salus populi* is in this, as it should be in every similar matter, the prime consideration; and the tax which is best fitted to promote, or least opposed to, this great end, though it may not press quite equally on the different orders of society, is to be preferred to a more equal but otherwise less advantageous tax. Were Smith's first maxim restricted to taxes laid directly on property or income, it would be quite as true in a practical as in a theoretical point of view. Equality is of the essence of such taxes; and whenever they cease to be equal, they become partial and unjust. But in laying down a practical rule that is to apply to all taxes, equality of contribution is an inferior consideration. The distinguishing characteristic of the best tax is, not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is, at the same time, most conducive, all things considered, to the public interests.

The truth is, that the greater number of taxes, including, we believe, every one that is least injurious, are imposed without any regard to the equality of their pressure. They consist of duties payable by those who use certain articles or exercise certain privileges, and by those only. Taxes of this sort, though not proportioned to the abilities of the consumers, are neither partial nor unfair; and provided they be imposed on proper objects, and kept within reasonable limits, they do not appear to be open to any good objection.

We may refer, in illustration of this statement, to the duties

on malt, spirits, wine, and tobacco. These produce a very large annual revenue; and though some of them might, perhaps, be advantageously reduced, they appear — supposing them to be properly assessed — to be, in all respects, unexceptionable. Other duties of this description, such as those on saddle horses, carriages, and livery servants, fall only on the more opulent classes. But this is not the case with the more productive duties; and it must be admitted that the largest portion of the revenue derived from them is paid by the lower and poorer orders. This, however, is not, as has been often alleged, a consequence of the latter being overtaxed, but of their being so very numerous that the produce of taxes to which they generally contribute invariably exceeds the produce of heavier taxes falling exclusively on the richer classes. The duties now under consideration act, in fact, as a species of improved sumptuary laws, having all the useful with few or none of the injurious influences of these regulations. . . .

But though it will, perhaps, be generally admitted that reasonable duties on spirits, tobacco, and such like articles, cannot be justly objected to, it may be contended, with some show of reasoning, that duties on necessaries, or on bread, butchers' meat, salt, tea, sugar, etc., are unjust and unfair, because of their being indispensable to the consumption of the poor as well as the rich. The injury, however, which is done to the poor by moderate taxes on necessaries is more apparent than real; for, as will be afterward shown, wages are, in most cases, increased proportionally to the amount of such taxes. And it commonly, also, happens that the quantity of an article used previously to its being burdened with a moderate duty, may be diminished, or something else be substituted in its stead, or the duty be defrayed by the exercise of greater economy or industry, without entailing any very serious privations on the consumers.

Without, however, insisting on these considerations, we deny that taxes on necessaries can be fairly objected to on the ground of their being unjust. They may, if carried to too great a height, be oppressive, and they may sometimes, perhaps, be inexpedient; but the charge of injustice is not one that can ever be truly made against them. Government has nothing to do with the means of the parties who buy taxed articles. It has

done its duty when it has imposed equal and moderate taxes on the articles best suited to bear taxation. Providence has not been charged with injustice because the corn and other articles used indifferently by the poor and the rich cost the one class as much as they cost the other. And, such being the case, how can it be pretended that governments, in laying equal duties on these articles, commit injustice? A rich man will, of course, pay taxes, and everything else, with less inconvenience than one who is poor. But is that any reason why he should be unfairly treated? or mulcted of a part of his fortune, by being subjected to peculiarly high rates of taxation? Riches are an evidence of superior good conduct; for, in the vast majority of cases, they are the result either of their possessors having themselves been, or of their having succeeded to progenitors who were, comparatively enterprising, industrious, and frugal. The distinction of rich and poor is not artificial. It originates in, and is a consequence of, the differences in the character and economy of individuals. A government which should attempt to obliterate this ineradicable distinction by varying duties so as to increase their pressure on the more opulent classes would be guilty of flagrant injustice. And it would, by discouraging the exercise of those virtues which are most essential to the public welfare, do its best to sap the foundations and weaken the springs of national prosperity and civilization.

So long, therefore, as duties are imposed on proper objects, and not carried to too great a height, we have yet to learn on what grounds they can be fairly objected to. A revenue must be raised by one means or other; and we are sanguine enough to believe that it will be sufficiently demonstrated in the sequel that such portion of it as may be raised by consumption duties will be the least onerous.

And, elsewhere,[1] McCulloch turned his guns upon Say's arguments in favor of progressive taxation:

It has been contended by Say, and some other economists, that taxes on income should be imposed on a graduated scale, and made to increase according to the increase of the incomes subjected to their operation. And the countenance which has been so frequently and cordially given to proposals for the intro-

[1] Treatise on Taxation, 139–141 (second edition).

duction of property and income taxes by the more dangerous class of politicians has originated in their supposing that they might be made to embrace a plan of graduation. And, though in the last degree objectionable, it is not to be denied that there is something exceedingly plausible in this plan. A tax of £10 is said to be more severely felt by the possessor of an income of £100, or of a property of that amount, than a tax of £100, or £1000, by the possessor of an income or of a property of £1000 or £10,000; and it is argued that, in order fairly to proportion the tax to the ability of the contributors, such a graduated scale of duty should be adopted as should press lightly on the smaller class of properties and incomes, and increase according as they become larger and more able to bear taxation. We take leave, however, to protest against this proposal, which is not more seductive than it is unjust and dangerous. No tax on income can be a just tax unless it leaves individuals in the same relative condition in which it found them. It must of course depress, according to its magnitude, all those on whom it falls; and it should fall on every one in proportion to the revenue which he enjoys under the protection of the state.[1] If it either pass entirely over some classes, or press on some less heavily than on others, it is unjustly imposed. Government, in such a case, has plainly stepped out of its proper province, and has assessed the tax, not for the legitimate purpose of appropriating a certain proportion of the revenues of its subjects to the public exigencies, but that it might at the same time regulate the incomes of the contributors; that is, it might depress one class and elevate another. The toleration of such a principle would necessarily lead to every species of abuse. That equal taxes on property or income are more severely felt by the poorer than by the richer classes is undeniable. But the same is true of every payment which does not subvert the existing relations among the different orders of society. The hardship in question is, in truth, a consequence of the inequality of fortunes, and to attempt to alleviate it by adopting a graduated scale of duties would really be to impose taxes on the wealthier part of the community for the benefit of their less opulent brethren, and

[1] That is, of course, supposing all revenues reduced to the same denomination, or to perpetuities.

not for the sake of the public revenue. Let it not be supposed that the principle of graduation may be carried to a certain extent, and then stopped.

Nullus semel ore receptus
Pollutas patitur sanguis mansuescere fauces.

The reasons that made the step be taken in the first instance, backed as they are sure to be by agitation and clamor, will impel you forward. Having once given way, having said that a man with £500 a year shall pay 5 per cent, another with £1000 10 per cent, and another with £2000 20 per cent, on what pretense or principle can you stop in your ascending scale? Why not take 50 per cent from the man of £2000 a year, and confiscate all the higher class of incomes before you tax the lower? In such matters the maxim of *obsta principiis* should be firmly adhered to by every prudent and honest statesman. Graduation is not an evil to be paltered with. Adopt it and you will effectually paralyze industry and check accumulation; at the same time that every man who has any property will hasten, by carrying it out of the country, to protect it from confiscation. The savages described by Montesquieu, who to get at the fruit cut down the tree, are about as good financiers as the advocates of this sort of taxes. Wherever they are introduced, security is at an end. Even if taxes on income were otherwise the most unexceptionable, the adoption of the principle of graduation would make them about the very worst that could be devised. The moment you abandon, in the framing of such taxes, the cardinal principle of exacting from all individuals the same proportion of their income or of their property, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit.

31. The Views of John Stuart Mill. — In his Principles of Political Economy [1] Mr. Mill considers at some length what constitutes equality in taxation:

For what reason ought equality to be the rule in matters of taxation? For the reason, that it ought to be so in all affairs of

[1] Bk. V, ch. 2, §§ 2–4.

government. As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all; which, it must be observed, is the mode by which least sacrifice is occasioned on the whole. If any one bears less than his fair share of the burthen, some other person must suffer more than his share, and the alleviation to the one is not, on the average, so great a good to him as the increased pressure upon the other is an evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person toward the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his. This standard, like other standards of perfection, cannot be completely realized; but the first object in every practical discussion should be to know what perfection is.

There are persons, however, who are not content with the general principles of justice as a basis to ground a rule of finance upon, but must have something, as they think, more specifically appropriate to the subject. What best pleases them is, to regard the taxes paid by each member of the community as an equivalent for value received, in the shape of service to himself; and they prefer to rest the justice of making each contribute in proportion to his means, upon the ground that he who has twice as much property to be protected, receives, on an accurate calculation, twice as much protection, and ought, on the principles of bargain and sale, to pay twice as much for it. Since, however, the assumption that government exists solely for the protection of property, is not one to be deliberately adhered to; some consistent adherents of the *quid pro quo* principle go on to observe, that protection being required for person as well as property, and everybody's person receiving the same amount of protection, a poll tax of a fixed sum per head is a proper equivalent for this part of the benefits of government; while the remaining part, protection to property, should be paid for in proportion to property. There is in this adjustment a false air of nice adaptation, very acceptable to some minds. But in the first place, it is not admissible that the protection of persons and that of prop-

erty are the sole purposes of government. The ends of government are as comprehensive as those of the social union. They consist of all the good, and all the immunity from evil, which the existence of government can be made either directly or indirectly to bestow. In the second place, the practice of setting definite values on things essentially indefinite, and making them a ground of practical conclusions, is peculiarly fertile in false views of social questions. It cannot be admitted, that to be protected in the ownership of ten times as much property is to be ten times as much protected. Neither can it be truly said that the protection of £1000 a year costs the state ten times as much as that of £100 a year, rather than twice as much, or exactly as much. The same judges, soldiers, sailors, who protect the one protect the other; and the larger income does not necessarily, though it may sometimes, require even more policemen. Whether the labor and expense of the protection, or the feelings of the protected person, or any other definite thing be made the standard, there is no such proportion as the one supposed, nor any other definable proportion. If we wanted to estimate the degrees of benefit which different persons derive from the protection of government, we should have to consider who would suffer most if that protection were withdrawn: to which question if any answer could be made, it must be, that those would suffer most who were weakest in mind or body, either by nature or by position. Indeed, such persons would almost infallibly be slaves. If there were any justice, therefore, in the theory of justice now under consideration, those who are least capable of helping or defending themselves, being those to whom the protection of government is the most indispensable, ought to pay the greatest share of its price: the reverse of the true idea of distributive justice, which consists not in imitating but in redressing the inequalities and wrongs of nature.

Government must be regarded as so preëminently a concern of all, that to determine who are most interested in it is of no real importance. If a person or class of persons receive so small a share of the benefit as makes it necessary to raise the question, there is something else than taxation which is amiss, and the thing to be done is to remedy the defect, instead of recognizing it and making it a ground for demanding less taxes.

As, in a case of voluntary subscription for a purpose in which all are interested, all are thought to have done their part fairly when each has contributed according to his means, that is, has made an equal sacrifice for the common object; in like manner should this be the principle of compulsory contributions: and it is superfluous to look for a more ingenious or recondite ground to rest the principle upon.

Setting out, then, from the maxim that equal sacrifices ought to be demanded from all, we have next to inquire whether this is in fact done, by making each contribute the same percentage on his pecuniary means. Many persons maintain the negative, saying that a tenth part taken from a small income is a heavier burthen than the same fraction deducted from one much larger: and on this is grounded the very popular scheme of what is called a graduated property tax, *viz.* an income tax in which the percentage rises with the amount of the income.

On the best consideration I am able to give to this question, it appears to me that the portion of truth which the doctrine contains arises principally from the difference between a tax which can be saved from luxuries, and one which trenches, in ever so small a degree, upon the necessaries of life. To take a thousand a year from the possessor of ten thousand, would not deprive him of anything really conducive either to the support or to the comfort of existence; and if such *would* be the effect of taking £5 from one whose income is £50, the sacrifice required from the last is not only greater than, but entirely incommensurable with, that imposed upon the first. The mode of adjusting these inequalities of pressure which seems to be the most equitable, is that recommended by Bentham, of leaving a certain minimum of income, sufficient to provide the necessaries of life, untaxed. Suppose £50 a year to be sufficient to provide the number of persons ordinarily supported from a single income, with the requisites of life and health, and with protection against habitual bodily suffering, but not with any indulgence. This then should be made the minimum, and incomes exceeding it should pay taxes not upon their whole amount, but upon the surplus. If the tax be 10 per cent, an income of £60 should be considered as a net income of £10, and charged with £1 a year, while an income of £1000 should be charged as one

of £950. Each would then pay a fixed proportion, not of his whole means, but of his superfluities. An income not exceeding £50 should not be taxed at all, either directly or by taxes on necessaries; for as by supposition this is the smallest income which labor ought to be able to command, the government ought not to be a party to making it smaller. This arrangement, however, would constitute a reason, in addition to others which might be stated, for maintaining taxes on articles of luxury consumed by the poor. The immunity extended to the income required for necessaries, should depend on its being actually expended for that purpose; and the poor who, not having more than enough for necessaries, divert any part of it to indulgences, should like other people contribute their quota out of those indulgences to the expenses of the state.

The exemption in favor of the smaller incomes should not, I think, be stretched further than to the amount of income needful for life, health, and immunity from bodily pain. If £50 a year is sufficient (which may be doubted) for these purposes, an income of £100 a year would, as it seems to me, obtain all the relief it is entitled to, compared with one of £1000, by being taxed only on £50 of its amount. It may be said, indeed, that to take £100 from £1000 (even giving back five pounds) is a heavier impost than £1000 taken from £10,000 (giving back the same five pounds). But this doctrine seems to me too disputable altogether, and even if true at all, not true to a sufficient extent, to be made the foundation of any rule of taxation. Whether the person with £10,000 a year cares less for £1000 than the person with only £1000 a year cares for £100, and if so, how much less, does not appear to me capable of being decided with the degree of certainty on which a legislator or a financier ought to act.

Some indeed contend that the rule of proportional taxation bears harder upon the moderate than upon the large incomes, because the same proportional payment has more tendency in the former case than in the latter to reduce the payer to a lower grade of social rank. The fact appears to me more than questionable. But even admitting it, I object to its being considered incumbent on government to shape its course by such considerations, or to recognize the notion that social importance is or

can be determined by amount of expenditure. Government ought to set an example of rating all things at their true value, and riches, therefore, at the worth, for comfort or pleasure, of the things which they will buy: and ought not to sanction the vulgarity of prizing them for the pitiful vanity of being known to possess them, or the paltry shame of being suspected to be without them, the presiding motives of three fourths of the expenditure of the middle classes. The sacrifices of real comfort or indulgence which government requires, it is bound to apportion among all persons with as much equality as possible; but their sacrifices of the imaginary dignity, dependent on expense, it may spare itself the trouble of estimating.

Both in England and on the Continent a graduated property tax has been advocated, on the avowed ground that the state should use the instrument of taxation as a means of mitigating the inequalities of wealth. I am as desirous as any one, that means should be taken to diminish those inequalities, but not so as to relieve the prodigal at the expense of the prudent. To tax the larger incomes at a higher percentage than the smaller, is to lay a tax on industry and economy; to impose a penalty on people for having worked harder and saved more than their neighbors. It is not the fortunes which are earned, but those which are unearned, that it is for the public good to place under limitation. A just and wise legislation would abstain from holding out motives for dissipating rather than saving the earnings of honest exertion. Its impartiality between competitors would consist in endeavoring that they should all start fair, and not in hanging a weight upon the swift to diminish the distance between them and the slow. Many, indeed, fail with greater efforts than those with which others succeed, not from difference of merits, but difference of opportunities; but if all were done which it would be in the power of a good government to do, by instruction and by legislation, to diminish this inequality of opportunities, the differences of fortune arising from people's own earnings could not justly give umbrage. With respect to the large fortunes acquired by gift or inheritance, the power of bequeathing is one of those privileges of property which are fit subjects for regulation on grounds of general expediency; and I have already suggested, as a possible mode of restraining the accumulation of large

fortunes in the hands of those who have not earned them by exertion, a limitation of the amount which any one person should be permitted to acquire by gift, bequest, or inheritance. Apart from this, and from the proposal of Bentham (also discussed in a former chapter) that collateral inheritance in case of intestacy should cease, and the property escheat to the state, I conceive that inheritances and legacies, exceeding a certain amount, are highly proper subjects for taxation: and that the revenue from them should be as great as it can be made without giving rise to evasions, by donation during life or concealment of property, such as it would be impossible adequately to check. The principle of graduation (as it is called,) that is, of levying a larger percentage on a larger sum, though its application to general taxation would be in my opinion objectionable, seems to me both just and expedient as applied to legacy and inheritance duties.

The objection to a graduated property tax applies in an aggravated degree to the proposition of an exclusive tax on what is called "realized property," that is, property not forming a part of any capital engaged in business, or rather in business under the superintendence of the owner: as land, the public funds, money lent on mortgage, and shares (I presume) in joint-stock companies. Except the proposal of applying a sponge to the national debt, no such palpable violation of common honesty has found sufficient support in this country, during the present generation, to be regarded as within the domain of discussion. It has not the palliation of a graduated property tax, that of laying the burthen on those best able to bear it; for "realized property" includes the far larger portion of the provision made for those who are unable to work, and consists, in great part, of extremely small fractions. I can hardly conceive a more shameless pretension than that the major part of the property of the country, that of merchants, manufacturers, farmers, and shopkeepers, should be exempted from its share of taxation; that these classes should only begin to pay their proportion after retiring from business, and if they never retire, should be excused from it altogether. But even this does not give an adequate idea of the injustice of the proposition. The burthen thus exclusively thrown on the owners of the smaller portion of the wealth of the community, would not even be a burthen on that *class* of persons

in perpetual succession, but would fall exclusively on those who happened to compose it when the tax was laid on. As land and those particular securities would thenceforth yield a smaller net income, relatively to the general interest of capital and to the profits of trade, the balance would rectify itself by a permanent depreciation of those kinds of property. Future buyers would acquire land and securities at a reduction of price, equivalent to the peculiar tax, which tax they would, therefore, escape from paying; while the original possessors would remain burthened with it even after parting with the property, since they would have sold their land or securities at a loss of value equivalent to the fee simple of the tax. Its imposition would thus be tantamount to the confiscation for public uses of a percentage of their property, equal to the percentage laid on their income by the tax. That such a proposition should find any favor is a striking instance of the want of conscience in matters of taxation, resulting from the absence of any fixed principles in the public mind, and of any indication of a sense of justice on the subject in the general conduct of governments. Should the scheme ever enlist a large party in its support, the fact would indicate a laxity of pecuniary integrity in national affairs, scarcely inferior to American repudiation.

Whether the profits of trade may not rightfully be taxed at a lower rate than incomes derived from interest or rent, is part of the more comprehensive question, so often mooted on the occasion of the present income tax, whether life incomes should be subjected to the same rate of taxation as perpetual incomes; whether salaries, for example, or annuities, or the gains of professions, should pay the same percentage as the income from inheritable property.

The existing tax treats all kinds of incomes exactly alike, taking its sevenpence (now sixpence) in the pound as well from the person whose income dies with him, as from the landholder, stockholder, or mortgagee, who can transmit his fortune undiminished to his descendants. This is a visible injustice; yet it does not arithmetically violate the rule that taxation ought to be in proportion to means. When it is said that a temporary income ought to be taxed less than a permanent one, the reply is irresistible, that it is taxed less; for the income which lasts only

ten years pays the tax only ten years, while that which lasts forever pays forever. On this point some financial reformers are guilty of a great fallacy. They contend that incomes ought to be assessed to the income tax not in proportion to their annual amount, but to their capitalized value: that, for example, if the value of a perpetual annuity of £100 is £3000, and a life annuity of the same amount being worth only half the number of years' purchase could only be sold for £1500, the perpetual income should pay twice as much per cent income tax as the terminable income; if the one pays £10 a year, the other should pay only £5. But in this argument there is the obvious oversight, that it values the incomes by one standard and the payments by another; it capitalizes the incomes, but forgets to capitalize the payments. An annuity worth £3000 ought, it is alleged, to be taxed twice as highly as one which is only worth £1500, and no assertion can be more unquestionable; but it is forgotten that the income worth £3000 pays to the supposed income tax £10 a year in perpetuity, which is equivalent, by supposition, to £300, while the terminable income pays the same £10 only during the life of its owner, which on the same calculation is a value of £150, and could actually be bought for that sum. Already, therefore, the income which is only half as valuable, pays only half as much to the tax; and if in addition to this its annual quota were reduced from £10 to £5, it would pay, not half, but a fourth part only of the payment demanded from the perpetual income. To make it just that the one income should pay only half as much per annum as the other, it would be necessary that it should pay that half for the same period, that is, in perpetuity.

The rule of payment which this school of financial reformers contend for, would be very proper if the tax were only to be levied once, to meet some national emergency. On the principle of requiring from all payers an equal sacrifice, every person who had anything belonging to him, reversioners included, would be called on for a payment proportioned to the present value of his property. I wonder it does not occur to the reformers in question, that precisely because this principle of assessment would be just in the case of a payment made once for all, it cannot possibly be just for a permanent tax.

When each pays only once, one person pays no oftener than another; and the proportion which would be just in that case, cannot also be just if one person has to make the payment only once, and the other several times. This, however, is the type of the case which actually occurs. The permanent incomes pay the tax as much oftener than the temporary ones, as a perpetuity exceeds the certain or uncertain length of time which forms the duration of the income for life or years.

All attempts to establish a claim in favor of terminable incomes on numerical grounds — to make out, in short, that a proportional tax is not a proportional tax — are manifestly absurd. The claim does not rest on grounds of arithmetic, but of human wants and feelings. It is not because the temporary annuitant has smaller means, but because he has greater necessities, that he ought to be assessed at a lower rate.

In spite of the nominal equality of income, A, an annuitant of £1000 a year, cannot so well afford to pay £100 out of it, as B, who derives the same annual sum from heritable property, A having usually a demand on his income which B has not, namely, to provide by saving for children or others, to which, in the case of salaries or professional gains, must generally be added a provision for his own later years; while B may expend his whole income without injury to his old age, and still have it all to bestow on others after his death. If A, in order to meet these exigencies, must lay by £300 of his income, to take £100 from him as income tax is to take £100 from £700, since it must be retrenched from that part only of his means which he can afford to spend on his own consumption. Were he to throw it ratably on what he spends and on what he saves, abating £70 from his consumption and £30 from his annual saving, then indeed his immediate sacrifice would be proportionally the same as B's: but then his children or his old age would be worse provided for in consequence of the tax. The capital sum which would be accumulated for them would be one tenth less, and on the reduced income afforded by this reduced capital, they would be a second time charged with income tax; while B's heirs would only be charged once.

The principle, therefore, of equality of taxation, interpreted in its only just sense, equality of sacrifice, requires that a person

who has no means of providing for old age, or for those in whom he is interested, except by saving from income, should have the tax remitted on all that part of his income which is really and *bonâ fide* applied to that purpose.

If, indeed, reliance could be placed on the conscience of the contributors, or sufficient security taken for the correctness of their statements by collateral precautions, the proper mode of assessing an income tax would be to tax only the part of income devoted to expenditure, exempting that which is saved. For when saved and invested (and all savings, speaking generally, are invested), it thenceforth pays income tax on the interest or profit which it brings, notwithstanding that it has already been taxed on the principal. Unless, therefore, savings are exempted from income tax, the contributors are twice taxed on what they save, and only once on what they spend. A person who spends all he receives pays *7d.* in the pound, or say 3 per cent, to the tax, and no more; but if he saves part of the year's income and buys stock, then in addition to the 3 per cent which he has paid on the principal, and which diminishes the interest in the same ratio, he pays 3 per cent annually on the interest itself, which is equivalent to an immediate payment of a second 3 per cent on the principal. So that while unproductive expenditure pays only 3 per cent, savings pay 6 per cent; or more correctly, 3 per cent on the whole, and another 3 per cent on the remaining 97. The difference thus created to the disadvantage of prudence and economy, is not only impolitic but unjust. To tax the sum invested, and afterward tax also the proceeds of the investment, is to tax the same portion of the contributor's means twice over. The principal and the interest cannot both together form part of his resources; they are the same portion twice counted: if he has the interest, it is because he abstains from using the principal; if he spends the principal, he does not receive the interest. Yet because he can do either of the two, he is taxed as if he could do both, and could have the benefit of the saving and that of the spending, concurrently with one another.

It has been urged as an objection to exempting savings from taxation, that the law ought not to disturb, by artificial interference, the natural competition between the motives for saving

and those for spending. But we have seen that the law disturbs this natural competition when it taxes savings, not when it spares them; for as the savings pay at any rate the full tax as soon as they are invested, their exemption from payment in the earlier stage is necessary to prevent them from paying twice, while money spent in unproductive consumption pays only once. It has been further objected, that since the rich have the greatest means of saving, any privilege given to savings is an advantage bestowed on the rich at the expense of the poor. I answer, that it is bestowed on them only in proportion as they abdicate the personal use of their riches; in proportion as they divert their income from the supply of their own wants, to a productive investment, through which, instead of being consumed by themselves, it is distributed in wages among the poor. If this be favoring the rich, I should like to have it pointed out, what mode of assessing taxation can deserve the name of favoring the poor.

No income tax is really just, from which savings are not exempted; and no income tax ought to be voted without that provision, if the form of the returns, and the nature of the evidence required, could be so arranged as to prevent the exemption from being taken fraudulent advantage of, by saving with one hand and getting into debt with the other, or by spending in the following year what had been passed tax free as saving in the year preceding. If this difficulty could be surmounted, the difficulties and complexities arising from the comparative claims of temporary and permanent incomes, would disappear; for since temporary incomes have no just claim to lighter taxation than permanent incomes, except in so far as their possessors are more called upon to save, the exemption of what they do save would fully satisfy the claim. But if no plan can be devised for the exemption of actual savings, sufficiently free from liability to fraud, it is necessary, as the next thing in point of justice, to take into account in assessing the tax, what the different classes of contributors *ought* to save. And there would probably be no other mode of doing this than the rough expedient of two different rates of assessment. There would be great difficulty in taking into account differences of duration between one terminable income and another; and in the most

frequent case, that of incomes dependent on life, differences of age and health would constitute such extreme diversity as it would be impossible to take proper cognizance of. It would probably be necessary to be content with one uniform rate for all incomes of inheritance, and another uniform rate for all those which necessarily terminate with the life of the individual. In fixing the proportion between the two rates, there must inevitably be something arbitrary; perhaps a deduction of one fourth in favor of life incomes would be as little objectionable as any which could be made, it being thus assumed that one fourth of a life income is, on the average of all ages and states of health, a suitable proportion to be laid by as a provision for successors and for old age.

Of the net profits of persons in business, a part, as before observed, may be considered as interest on capital, and of a perpetual character, and the remaining part as remuneration for the skill and labor of superintendence. The surplus beyond interest depends on the life of the individual, and even on his continuance in business, and is entitled to the full amount of exemption allowed to terminable incomes. It has also, I conceive, a just claim to a further amount of exemption in consideration of its precariousness. An income which some not unusual vicissitude may reduce to nothing, or even convert into a loss, is not the same thing to the feelings of the possessor as a permanent income of £1000 a year, even though on an average of years it may yield £1000 a year. If life incomes were assessed at three fourths of their amount, the profits of business, after deducting interest on capital, should not only be assessed at three fourths, but should pay, on that assessment, a lower rate. Or perhaps the claims of justice in this respect might be sufficiently met by allowing the deduction of a fourth on the entire income, interest included.

These are the chief cases, of ordinary occurrence, in which any difficulty arises in interpreting the maxim of equality of taxation. The proper sense to be put upon it, as we have seen in the preceding example, is, that people should be taxed, not in proportion to what they have, but to what they can afford to spend. It is no objection to this principle that we cannot apply it consistently to all cases. A person with a life income and

precarious health, or who has many persons depending on his exertions, must, if he wishes to provide for them after his death, be more rigidly economical than one who has a life income of equal amount, with a strong constitution, and few claims upon him; and if it be conceded that taxation cannot accommodate itself to these distinctions, it is argued that there is no use in attending to any distinctions, where the absolute amount of income is the same. But the difficulty of doing perfect justice, is no reason against doing as much as we can. Though it may be a hardship to an annuitant whose life is only worth five years' purchase, to be allowed no greater abatement than is granted to one whose life is worth twenty, it is better for him even so, than if neither of them were allowed any abatement at all.

32. Wagner's Socio-political Theory of Taxation. — A radically different point of departure is represented by the eminent German economist, Adolph Wagner, who distinguishes between the purely fiscal and the socio-political theories of justice in taxation. In earlier times, Wagner says, financial problems were treated from the purely fiscal point of view, that is, with a view solely to raising a sufficient revenue to meet the needs of the government. But the modern view, he says,[1] is, or should be, different:

The modern science of economics not only recognizes the mutual dependence of public and private economic activity, and their mutually complementary character; it also renounces the optimistic view of the present organization of private industry, and recognizes the great evils in the system of free competition. It has come to know that the organization of productive industry by private initiative, the existing institution of property — especially in land and productive capital, and the distribution of wealth which takes place upon this basis, have a decisive social influence. It knows that through this process the power and relations both of individuals and of classes are determined in modern economic society. At the same time our science recognizes the influence which the state exercises directly or indirectly

[1] Finanzwissenschaft, Vol. I, § 27.

upon the distribution of wealth and position of social classes, by the form which its activity takes, by the manner in which it spends its revenues, by the kinds of taxation it adopts, and by the creation of public debts.

From this knowledge our science has developed two demands. In the first place, the state should so order its expenditures, tax system, and loans as to remove certain economic and social evils which have attended them in the past. And in the second place, the state, by adopting appropriate policies, should remedy evils which are not due to its previous action in financial or other matters. From this second demand it follows that, in the domain of public finance, expenditures should increase in order to enable the state to assume new functions; and that taxation, in addition to serving the purely financial purpose of providing sufficient revenue, should be employed for the purpose of bringing about a different distribution of wealth from that which would result from the working of free competition upon the basis of the present social order. It is the modern "social problem," influencing both scientific and public affairs, which is here beginning to work this transformation in the science of finance.

Later on Professor Wagner discusses, from his "socio-political" point of view, the question of justice in taxation. He says that one's views on this subject will depend upon what one thinks of that distribution of wealth which free competition would bring about upon the basis of the existing economic order. Thus he continues:[1]

One who considers the present economic order unconditionally just, and the only justifiable order, as the liberal school of the Physiocrats and Smith did, must logically consider the existing distribution of wealth, which results from this order, as the only righteous and just distribution. This conclusion the keener thinkers of the school have drawn and definitely formulated. For a person of this opinion the existing distribution of wealth is, therefore, a fact admitting of no further discussion and to be accepted with all of its consequences. One of these consequences

[1] Finanzwissenschaft, Vol. II, § 159.

is that the expenditure of the same amount of money presses with unequal severity upon persons with different incomes and in different economic circumstances; or, conversely, that the ability of these persons to bear the same expenditure varies according to the conditions just mentioned. It follows, then, that taxation should not alter the existing distribution, which is considered to be just. In this view of the case, therefore, taxation will be confined strictly to the purpose of raising sufficient revenue; and the socio-political theory of taxation, which has already been stated, will be rejected.

The consequences of this view, so far as the concept of justice and the demand for universality and equality in taxation are concerned, is briefly as follows:

1. The duty of all to pay taxes (universality) is interpreted literally. Every citizen is required, as a matter of principle, to pay taxes, whether his income is small or large, whether it is derived from invested property or from personal exertions. There should be no exemption of the "minimum of subsistence."

2. Equality in taxation is believed to be proportionality of taxes to income; that is, every one should pay in taxes the same proportion of his income. The result is proportional taxation, or levying the same per cent upon all incomes, and the rejection of progressive taxation of the larger incomes, as well as the equal taxation of funded and unfunded incomes. . . .

The theory thus briefly, but sufficiently, sketched may be called the purely financial or fiscal theory of taxation, in order to distinguish it from the theory now to be presented. The correctness of the conclusion concerning universality and justice of taxation is not to be questioned if the premise is conceded to be true. This premise is the justice of the distribution of wealth brought about by free competition. The conclusion stands or falls with the premise.

Again referring to my earlier discussion of competition in my Grundlegung,[1] discussion which cannot be repeated here, it is to be said that the premise cannot be admitted to be true, — at least in the universal application given it by the liberal school of economics. . . . Therefore the conclusion that the distribution established by competition is not to be disturbed by taxa-

[1] Grundlegung der politischen Oekonomie, especially Bk. V, ch. 2. — Ed.

tion, is not universally true. We need, rather, beside the purely financial theory of taxation, to establish a second, — the socio-political, by which a tax becomes something more than a means of raising revenue, and is considered a means of correcting that distribution of wealth which results from competition. This is to be brought about particularly by discriminating as sharply as possible between "earned" incomes and incomes resulting from chance or speculative gains. . . . And then, with the incomes drawn from ordinary industry, we must distinguish more sharply between income derived from labor and income derived from property; and we must consider that the larger gains, and the accumulation of property which they render possible, usually result more or less from good fortune as well as from the personal contributions of the recipients. Furthermore, only from the socio-political standpoint can due consideration be given to the undeniable fact that the larger incomes represent greater ability to pay taxes than the smaller incomes represent, and that income from property indicates greater ability than income from labor. And, finally, from this standpoint, can be justified the policy of favoring classes of persons with small and precarious incomes or incomes derived wholly from labor, by means of certain exemptions from taxation. Such exemptions necessarily lead to higher taxation of the wealthier classes, but they are, from this standpoint, quite as justifiable as the institutions already maintained, at public expense, for the benefit of the poorer classes, such as schools.

So far as concerns the postulates of universality and equality in taxation, the results of the socio-political theory are as follows:

1. Universality is not interpreted literally, even for those who are members of the state. It permits the exemption of persons with small incomes, especially incomes derived from labor, from taxation in general or from the operation of certain taxes. This is the social demand for the exemption of a minimum of subsistence. . . .

2. Equality is, in this theory, considered to mean taxation as far as possible in proportion to ability to contribute, which increases more rapidly than the absolute amount of a person's income or property increases. Therefore the socio-political

theory demands progressive taxation of larger incomes and the rejection of mere proportional taxation. Furthermore it demands heavier taxation of funded incomes than of incomes derived from labor. . . . And, in strictness, only upon this socio-political theory can the taxation of inheritances find adequate justification. For, according to it, the rights of property and inheritance are not mere matters of course and wholly independent of the action of the state, as the liberal school believes them to be. These things are, on the contrary, a product of the legal activity of the state.

33. Professor Seligman's Criticism of Wagner's Theories. — The socio-political theory of taxation is vigorously criticised by Professor Seligman in his work on Progressive Taxation:[1]

The foremost scientific advocate of the socialistic theory of progression is the German economist, Adolph Wagner. Wagner distinguishes between the purely fiscal period in the history of public finance, and the socio-political period. The essence of the first period consists in the simple endeavor on the part of the government to raise a revenue adequate to its needs. The essence of the second period consists in the predominance of social reasons over purely fiscal reasons. The state is no longer satisfied merely with raising an adequate revenue, but now considers it a duty to interfere with the rights of private property in order to bring about a more equitable distribution of wealth. The fiscal policy looks merely to the needs of the administration; the socio-political policy looks at the relations of social classes to each other, and the best methods of satisfactorily adjusting these relations. The fiscal policy necessarily results in proportional taxation; the socio-political policy results in progressive taxation. The ethical demands of modern civilization are everywhere preparing the way for a transition from the old fiscal period to the incipient socio-political period. It is these ethical or social reasons alone which can logically serve as a basis for progressive taxation.

[1] Progressive Taxation in Theory and Practice, 66–70. In Publications of the American Economic Association, IX (1894). Reprinted by consent of the author and the Association.

This distinction of Wagner is, however, entirely baseless. It is not true historically that the tax policy of various nations has been adjusted solely with reference to purely fiscal reasons. All governments have allowed social considerations in the wider sense to influence their revenue policy. The whole system of protective duties has been framed not merely with reference to revenue considerations, but in order to produce results which should directly affect social and national prosperity. Taxes on luxuries have often been mere sumptuary laws designed as much to check consumption as to yield revenue. Excise taxes have frequently been levied from a wide social, as well as from a narrow fiscal, standpoint. From the very beginning of all tax systems these social reasons have often been present. The attempt to sharply distinguish such periods historically is, therefore, unsuccessful.

But, on the other hand, it is not allowable to confound this undoubtedly social element in all fiscal policy with what Wagner calls the socio-political, or what may be called more correctly the socialistic, element. From the principle that the state may modify its strict fiscal policy by considerations of general national utility to the principle that it is the duty of the state to redress all inequalities of fortune among its private citizens is a long and dangerous step. It would land us not only in socialism, but practically in communism. If this were one of the acknowledged functions of government, it would be useless to construct any science of finance. There would be only one simple principle: confiscate the property of the rich and give it to the poor.

The difference between the social element and Wagner's socio-political idea is the difference between social reform and socialism. We may indeed deprecate the existing conditions which affect the distribution of wealth. But where so much is spoken of just and unjust arrangements, it is necessary to come to an understanding exactly what justice means. Justice, in so far as the action of the state is concerned, consists in holding the balance equal; in giving none an undue advantage; in affording each individual equal rights before the law and equal opportunities to develop his own talents and resources. Justice indeed demands that the state should do nothing consciously and purposely to increase inequality of wealth; but it cannot demand

that the state should do away with inequality of wealth. Justice in the sense of equality may demand great changes in the existing forms of taxation; but that is a question by itself. It involves the problem of the equal treatment of all, as over against historic inequality and its survivals in the tax systems of the world to-day. In that sense indeed there is room and need for social reform; but it is a reform which consists in checking the continuance of old unequal laws, not in fostering the growth of new unequal laws. Legal justice means legal equality; but a legal equality which would attempt to force an equality of fortune in the face of inevitable inequalities of native ability would be a travesty of justice.

We may indeed grant the crying need for social reform. But in so far as the government is concerned the possibility of social reform lies rather in the general attitude of the legislator in social and industrial matters. And even in so far as finance is concerned, the chief social reforms are in the domain of outlay and expenditure rather than in that of revenue. The desirable social reforms consist in extending the benefits of governmental activity to the poor and needy, and in enabling even the lowest classes to participate, as far as possible, in the advantages of progressive civilization. Even here it is a question how far it is desirable to go; and the answer depends not alone on fiscal reasons, but also on wider considerations of general governmental policy. But at all events, the so-called socio-political theory is untenable in so far as it implies a conscious effort on the part of the state to levy higher taxes on the rich in order to reduce them to the level of the poor.

34. **Professor Seligman's Views concerning Progressive Taxation.** — Rejecting *in toto*, therefore, the theories of Wagner, Professor Seligman, after an exhaustive examination of the literature on the subject, presents his own views as follows:[1]

We have thus far learned the chief arguments urged for and against progressive taxation. We have seen the inadequacy of the socialistic and compensatory theories in favor of, and the weakness of the benefit theory in opposition to, the doctrine of

[1] Progressive Taxation, 190–200.

progression. And we have analyzed more closely the equal-sacrifice doctrine, and found that it is unable to serve as the basis of a definite and infallible scale of progression. Are we, then, to abandon progressive taxation in theory? It seems to me not, and for a convincing reason. We must revert to the fundamental conception of faculty or ability, which is, after all, the best standard we have of the measure of general obligation to pay taxes. What does the faculty theory in its wisest interpretation teach us in the matter?

President Walker's definition of faculty is well known.[1] Faculty, says he, is "the native or acquired power of production." But if we analyze faculty more closely, in the sense in which we instinctively use the word in tax matters, we see that it means something more than that. It not only implies native or acquired power of production, but includes at least also the opportunity of putting these powers to use, the manner in which the powers are actually employed, and the results of their use as measured by periodical or permanent accretion to the producer's possessions. We have seen how the original idea was that represented by President Walker, but how this was soon supplanted by the more real and practicable tests, first of property (or permanent accretion), then of income (or periodical accretion). But, furthermore, faculty connotes an additional conception. It means not only powers of production or results of powers of production, but also the capacity to make use of these powers or these results — the capacity, in other words, of enjoying the results of the exertions. It is this latter conception which has been developed by recent writers, although they have carried it to an extreme just as one-sided as that represented by the advocates of the earlier theories. The elements of faculty, then, are twofold — those connected with acquisition or production, and those connected with outlay or consumption. What is the application to the matter in hand?

If we regard only the first set of elements, it is evident that the possession of large fortunes or large incomes in itself affords the possessor a decided advantage in augmenting his possessions. The facility of increasing production often grows in

[1] F. A. Walker, The Bases of Taxation. *Political Science Quarterly*, III. (1888), p. 14.

more than arithmetical proportion. A rich man may be said to be subject in some sense to the law of increasing returns. The more he has, the easier it is for him to acquire still more. The initial disadvantages have been overcome. This was pointed out already by Adam Smith, when he said: "A great stock, though with small profits, generally increases faster than a small stock with great profits. Money, says the proverb, makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that little."[1] While the native power of production remains as before, this "acquired power" has greatly augmented. Hence, from this point of view, faculty may be said to increase faster than fortune or income. And this element of taxable capacity would not illogically result in a more than proportional rate of taxation.

On the other hand, the elements of faculty which are connected with outlay or consumption, bring us right back again to the sacrifice theory. While the idea of faculty includes that of sacrifice, the two ideas are not coextensive. Faculty is the larger, sacrifice the smaller, conception. Faculty includes two sets of considerations, sacrifice only one. Now, while the sacrifice theory in itself, as we have seen, is not sufficient to make us demand any fixed scale of progression, its influence in the other direction is certainly not strong enough to countervail the productive elements of faculty, which seem to imply progressive taxation. In fact, we may go further and say that the sacrifice theory, or consumption element in faculty, can certainly not be used as an argument necessarily leading to proportional taxation. It does not lead necessarily to any definite scale of progression; much less can it lead necessarily to a fixed proportional taxation. But if we never can reach an ideal, there is no good reason why we should not strive to get as close to it as possible. Equality of sacrifice, indeed, we can never attain absolutely or exactly, because of the diversity of individual wants and desires; but it is nevertheless most probable that in the majority of normal and typical cases, we shall be getting closer to the desired equality by some departure from proportional taxation. In certain individual cases even regressive taxation might accomplish the result best, in other individual

[1] Wealth of Nations, Bk. I, ch. 9.

cases proportional taxation would be the most serviceable. But if we take a general view, and treat of the average man — and the state can deal only with classes, that is, with average men — it seems probable that on the whole less injustice will be done by adopting some form of progression than by accepting the universal rule of proportion. A strictly proportional rate will make no allowance for the exemption of the minimum of subsistence. It will be a heavier burden on the typical average poor man than on the typical average rich man. It will be apt to be relatively more severely felt by the average man who has only a small surplus above socially necessary expenses, than by the average man who has a proportionally larger surplus. It will, in short, be apt in normal cases to disproportionately curtail the enjoyments of different social classes.

Hence, if we base our doctrine of the equities of taxation on the theory of faculty, both the production and the consumption sides of the theory seem to point to progressive taxation as at all events neither more illogical nor more unjust than proportional taxation. It may, indeed, frankly be conceded that the theory of faculty cannot point out any definite rate of progression as the ideally just rate. In so far there seems to be some truth in Mill's contention that progressive taxation cannot give that "degree of certainty" on which a legislator should act; as well as in McCulloch's assertion that when we abandon proportion we "are at sea without rudder or compass." It is true that proportion is in one sense certain, and progression is uncertain. But their argument proves too much. An uncertain rate, if it be in the general direction of justice, may nevertheless be preferable to a rate which, like that of proportion, may be more certain without being so equitable. Half a loaf is better than no bread. Stability is assuredly a good thing. But it is highly questionable whether a stability which is necessarily unjust is preferable to an instability that works in the general direction of what is recognized as justice. All governmental actions which have to do with money relations of classes are necessarily more or less arbitrary. The fines imposed by the courts, the fixing of the rates of import duties or excise taxes are always, to a certain extent, inexact. And in truth, a strict proportional tax, if we accept the point of view mentioned above, is really

more arbitrary as over against the individual taxpayers, than a moderately progressive tax. The ostensible "certainty" involves a really greater arbitrariness.

So, also, the other arguments often advanced against progression seem to be in some measure destitute of foundation.[1] The common objection that progression is confiscation because it must finally end by swallowing up the whole capital may be completely obviated, as we have seen, by making the rate of progression itself degressive,[2] so that it would become impossible to reach one hundred per cent or any like percentage of large fortunes.

The objection that it is a fine put on industry and saving is really not applicable to progressive taxation as such, but rather to the whole system of taxation on property or income. The logical conclusion from this would be the demand for taxation only on expense; and even that would be to a certain extent a tax on industry. But it is hard to see why industry and saving should not be taxed, if it increases our capacity to pay taxes; and it is still harder to see how we can avoid taxing industry. Furthermore, it is a mistake to assume that larger fortunes are always the result of individual saving. The argument, in short, is not an argument against progression, but against taxation in general. If a moderately progressive tax is really more equitable than a strictly proportional tax, progression will be less of a fine on thrift and industry than proportion would be.

Finally, the argument that progressive taxes are not productive of revenue is not of great weight. The contention has never been urged that progressive taxes yield less than proportional taxes, but simply that they do not yield more. Now, as it has already been pointed out in a previous chapter, the function of progressive taxation is not so much to obtain increased revenues as to apportion the burden more equally among the taxpayers. If it is conceded that the progressive tax is more equitable than the proportional tax, it is utterly immaterial whether it yields more revenue or not.

[1] The objections commonly urged are well summed up in Bastable, Public Finance, 308–313 (third edition).

[2] A degressive rate is one which increases up to a certain point, and thereafter remains constant. — Ed.

It is possible, therefore, to draw only this very vague conclusion as to the general legitimacy of the principle of progressive taxation. The practical application of the principle depends on a series of important considerations.

In the first place we are confronted by the question of incidence. If the theory of general diffusion of taxation be true, then it makes no difference whether we levy a proportional or progressive tax. For, since the tax would ultimately be shifted to the consumer, the taxpayer would not be injured, while the consumer would bear the tax only in proportion to what he consumed. It is a singular fact that this illogical procedure of the advocates of the diffusion theory has always been overlooked. For the most heated opponents of progressive taxation have been, like Thiers, advocates of the diffusion theory of taxation without perceiving the absurdity of their position. The diffusion theory of taxation, however, we know to be entirely unsound.[1] Nevertheless, in so far as taxes really are shifted at all from the taxpayer, the problem of progression loses its importance. For if taxes are actually shifted, the rate in the first instance is of no essential consequence. It is only in so far as we assume that so-called direct taxes remain where they are put, that the considerations of faculty or ability are of any weight. How far this assumption is true has been investigated in another place. For the purpose of the theoretical discussion it may be taken for granted that the problem of progression *versus* proportion must be treated on the hypothesis that the assumption is true. But when we come to construct a progressive rate in practice, we must be careful to ascertain how far the assumption conforms to reality. A progressive rate of taxation which does not reach individual faculty at all is as unnecessary as it is illogical.

Secondly, the defense of progression rests on the theory that it is applicable to general taxation, taken as a whole. It rests on the assumption that taxes are paid out of revenue, and that the whole system is framed with this end in view. But it is

[1] See my monograph on The Shifting and Incidence of Taxation, Publications of the American Economic Association, Vol. VII, Nos. 2 and 3. (This work has since been brought out in a second edition, revised and enlarged, New York, 1899.) — Ed.

obviously an immensely difficult task to shape a whole system of taxation so that the average general rate will be a moderately progressive one. Actual systems of taxation are of the most varied kinds. In some taxes it is impracticable to introduce a progressive scale, as they are by their very nature proportional, as, *e.g.*, tithes or poll taxes, — for a graduated poll tax is really not a poll tax at all, but a class tax. In other cases the taxes in actual life are even regressive, as, *e.g.*, many of the indirect taxes. It would be impossible thoroughly to carry out the principle of general progression unless we had a single universal income tax. But no scientific writer to-day favors a single income tax, or a single property tax, or for that matter a single tax of any kind. Thus, in advocating the system of progression, we must have regard to the facts of the individual case, and to the general sentiment of the community. In the United States, for instance, the general property tax in its practical operation is largely regressive, especially in so far as personalty is concerned. The tax reformers, as we shall see, have quite enough to occupy their attention in trying to make the rate really proportional, before bothering themselves with the more ideal stage of progression. But it is all the more worthy of consideration whether other taxes may not properly be levied according to the progressive principle. It is more than likely that a number of moderate progressive taxes would after all still simply result in securing an average proportional rate for the whole system of taxation. And we have seen that some defenders of proportion in theory admit the legitimacy of certain progressive taxes as a compensation for other really regressive taxes. In practice, then, we may frequently demand progressive taxes without being at all so extreme or so "communistic" as many persons believe.

Thirdly, the defense of progressive taxation rests on the assumption of faculty as the basis of taxation. Now while this is true of taxation as a whole, for general state purposes, it is questionable whether the principle of benefits is not of some weight in problems of purely local and municipal finance. A discussion of the contest between these two principles and the limits of their relative applicability to different phases of public revenues would take us too far astray here. But it may be

said that it is coming more and more to be recognized that within the domain of the taxing power the principle of benefits should be followed to some extent in strictly local finance.[1] If this is true, the principle of progression will be of rather more limited application to some of the charges employed for the support of local government; for the theory of benefits, as we have seen, leads logically to proportion, not to progression. Thus the practical sphere of the applicability of the progressive principle would be even more circumscribed.

Finally, it must not be overlooked that high rates of progression may engender or augment attempts at fraud and evasion. That this is possible cannot be denied. But, as has already been pointed out, the danger is apt to be greatly exaggerated. We know that there is certainly more fraud in the countries of proportional taxes like America than in the home of progressive taxes like Switzerland or Germany. Still it may be conceded that with progressive rates there would probably be even more fraud than actually exists, even though the fears of the doubters in Australia and Switzerland have not been realized. Much depends on the manner in which progression is applied, and the particular tax to which it is extended. Still more depends on the rate of the progression. The higher the progression, the more likely that the results will be perceptibly bad. But the objection is really one against the abuse, not the use, of the progressive principle.

If, therefore, we sum up the whole discussion, we see that while progressive taxation is to a certain extent defensible as an ideal, and as the expression of the theoretical demand for the shaping of taxes to the test of individual faculty, it is a matter of considerable difficulty to decide how far or in what manner the principle ought to be actually carried out in practice.

Theory itself cannot determine any definite scale of progression whatever. And while it is highly probable that the ends of justice would be more nearly subserved by some approximation to a progressive scale, considerations of expediency as well as the uncertainty of the interrelations between various parts of

[1] For a discussion of these points, see my article on The Classification of Public Revenues, *Quarterly Journal of Economics*, Vol. VII, pp. 311 *et seq.* (See also the author's Essays in Taxation, 265–304 (second edition, New York, 1900). — ED.

the entire tax system should tend to render us cautious in advocating any general application of the principle. It remains to investigate as to how far the principle is applicable to the conditions surrounding us in America to-day.[1] But, in last resort, the crucial point is the state of the social consciousness and the development of the feeling of civic obligation.

[1] In the following chapter of his monograph, Professor Seligman considers the practicability of progressive taxation, especially in the United States, and comes to the following conclusion:

"We see then that while progression of some sort is demanded from the standpoint of ideal justice, the practical difficulties in the way of its general application are well-nigh insuperable. Progression is defensible only on the theory that the taxes are so arranged as to strike every individual on his real income. But in default of a single tax on incomes, which is visionary, practicable tax systems can reach individual incomes only in a very rough and roundabout way. Under such practical conditions it is doubtful whether greater individual justice will be attained by a system of progression than by the simple rule of proportion; and it is questionable whether the ideal advantages of progression would not be outweighed by its practical shortcomings. For the United States at all events, the only important tax to which the progressive scale is at all applicable at present is the inheritance tax. For the future development of the idea we must rely on an improvement in the tax administration, on a more harmonious method of correlating the public revenues, and on a decided growth in the alacrity of individuals to contribute their due share to the common burdens." — Ed.

CHAPTER X

CAPITATION TAXES

35. The Poll Tax in American Commonwealths. — Although the poll tax has been abandoned in most of the countries of Europe,[1] it is still found in about half of the American states.[2] Sometimes it is a distinct state tax; sometimes it is associated with the general property tax; sometimes it is merely a local tax, and used for such local purposes as the care of highways. It is found in most of the New England and the Southern states, but less frequently in the Central or Western states. In many cases the tax is poorly collected, as may be illustrated by the experience of Wisconsin. In that state the poll tax is a local tax which in towns and villages is "to be collected for highway purposes only." In 1898 the Wisconsin Tax Commission reported that the law "has become practically a dead letter in many portions of the state"; that "more than half the towns and villages in the state and about two thirds of the cities did not collect any poll tax in 1897"; and that in eight counties "not a dollar of poll tax was collected." The net result was stated as follows:

Of the 1137 towns and villages in the state only 493 made any attempt to collect any poll taxes, and the total amount which they collected was $95,871.75. Of the 111 cities only 39 report any poll tax raised, and the total amount obtained was the comparatively small sum of $12,578.37.[3]

[1] Capitation taxes are employed in France and some of the Swiss cantons. The French personal tax (*impôt personnel*) will be described in the next chapter.

[2] The experience of the American states is described by Seligman in his monograph on Finance Statistics of American Commonwealths, in Publications of American Statistical Association, 1889.

[3] Report of the Wisconsin State Tax Commission, 1898, pp. 68 and 107.

36. The Poll Tax in Massachusetts. — The Commission of 1897 gave the following account of the working of the poll tax in Massachusetts:[1]

The Commonwealth of Massachusetts levies a poll or capitation tax on every male inhabitant of the Commonwealth above the age of twenty years, whether a citizen of the United States or an alien, and upon every female citizen of said age requesting to be assessed therefor. The poll tax of the old, poor, and infirm may be abated at the discretion of the assessors.

The assessors are required to canvass their respective cities and towns, and after diligent inquiry to make true lists of every male person above the age of twenty years residing in their city or town, and of all women of the like age who request to be assessed. In cities and towns of more than five thousand inhabitants the assessors are required to prepare and to have printed street lists arranged by voting precincts, designating all buildings used for residences, and giving the age, name, and occupation of every person assessed for a poll tax. These lists are sent to the registrars of voters, though it is not necessary for registration that the voter's name be entered upon this list. The registrars, on their part, are required to make a return to the assessors of the names of all persons who have registered with them and whose names are not upon the assessors' lists. The assessors, having obtained a list of all those liable for a poll tax, proceed to assess upon them the state and county taxes. The state tax is assessed upon the number of polls in each place until such assessment amounts to $1 upon each poll, the remainder of the tax being then assessed upon property. In like manner the county taxes are assessed upon the polls up to the sum of $1 on each poll, the remainder there also being assessed on property. The effect is that the rate of the poll tax is in almost all cities and towns $2 per year. In six localities only is there a less rate. In the city of Chelsea and in the towns of Winthrop and Revere the poll tax is only $1. This arises from the fact that the city of Boston assumes the entire county tax for the county of Suffolk; hence in these places the poll tax is limited to the state tax of $1.

[1] Report of the Commission on Taxation, pp. 3–5.

In three towns the amount of the total poll tax levied in the manner described above is less than $2, namely: Savoy, $1.80; Gay Head, $1.50; and Prescott, $1.97.

In former years payment of the tax was a condition of the exercise of the franchise. For that reason it was for the most part paid, — if not directly by the person upon whom it was assessed, then paid on his behalf by the political organization to which he belonged. By an amendment of the Constitution in 1891 the provision making the payment of the tax a prerequisite to voting was repealed. Since that time it has been difficult to collect the tax from those not subject to the tax for property. The amount in each case being small, the tax is now in the cities very largely uncollectible, except from persons who are also taxed for property.

Although the poll tax is thus, strictly speaking, a state and county tax, it is not to be inferred that the financial resources of the state or of the counties are affected by the difficulty of collecting it. The cities and towns pay over their respective shares of the state and county taxes, without regard to the success of their collection of the poll tax. They are accountable for contributing their apportioned quotas to state and counties, first by the poll tax and then by taxes on property. What they do not succeed in raising by the former tax they must make up by the latter.

The number of male persons assessed for poll tax in 1896 was 723,736; the number of persons assessed for poll tax only was 511,659; the amount of the tax assessed on polls was $1,434,629.[1]

37. The Poll Tax in North Carolina. — The poll tax has played a more important part in the history of North Carolina than in probably any other state in the American Union. Until the time of the Revolution North Carolina never employed any direct tax except that upon polls, in the assessment of which adult white males and adult colored males and females were included. Indirect taxation, moreover, was not very important, being confined for the most part to light duties on imported

[1] For 1904 the assessment upon polls was $1,676,726. — Ed.

spirits; so that the poll tax was almost the sole reliance of the finances of the colony.[1] During the Revolution the newly organized state began to tax a few kinds of property, chiefly land and buildings; but the poll tax continued, until the middle of the nineteenth century, to furnish about half of the state revenue.[2] Professor G. E. Barnett gives the following account of the working of the poll tax in North Carolina:[3]

In origin the poll tax is coincident with the beginnings of taxation in North Carolina. Until near the middle of the century, it furnished more revenue than the general property tax. This was in large measure due to the fact that the taxes on slaves could be collected by sale of the slaves. The great importance of the tax is clearly shown by the fact that all of the constitutional amendments of 1835 concerned the poll tax. These amendments provided that the capitation tax should be equal throughout the state, and that all free males over twenty-one and under forty-five years of age, and all slaves over twelve and under fifty years of age, should be subject to a capitation tax, and that no other person should be subject to such a tax. The capitation tax on slaves was in lieu of any other tax on such property.

In 1852 a part of the revenue derived from the poll tax was applied to the support of a state asylum for lunatics and idiots. In the constitution adopted in 1868, the poll tax was devoted to the support of the public schools and of the poor.

The state treasury no longer derives any revenue from this source, but the proceeds of the tax form a part of the school and poor fund of the county in which it is collected. Since,

[1] See Bullock, Essays in the Monetary History of the United States, 178, 192.

[2] Maryland and Virginia, during the colonial period, employed poll taxes very extensively; but had lucrative sources of revenue in import duties and export duties on tobacco. In these states property taxes were introduced during the eighteenth century, — in Virginia during the French and Indian War, and in Maryland during the Revolution, — and the poll tax thereafter was relegated to the background. In Maryland, in fact, poll taxes were discontinued entirely.

[3] Studies in State Taxation, edited by J. H. Hollander, Johns Hopkins Studies in Historical and Political Science, Series XVIII. Reprinted by consent of editor, author, and publisher.

however, the rate is prescribed by the General Assembly, it may properly be considered a commonwealth tax.

Rate. — The provision of the constitution authorizing the poll tax is mandatory. It declares, "The General Assembly shall levy a capitation tax on every male inhabitant in the state over twenty-one and under fifty years of age, which shall be equal to the tax on property valued at $300." The Supreme Court has recently held that if a revenue act does not preserve this proportion, the tax on both property and poll is void.

The present state poll tax is $1.29. The counties also have the privilege of levying a poll tax, but the state and county tax together must not exceed $2.00. Not more than one fifth of the revenue thus raised can be appropriated to the support of the poor. By the Constitution of 1868, the county commissioners are empowered to exempt from this tax any persons who are too poor or infirm to pay it.

Collection. — Much difficulty is experienced in the collection of the tax. The law provides that, "if any poll tax or other taxes shall not be paid within sixty days after the same shall be demandable it shall be the duty of the sheriff, if he can find no property of the person liable, sufficient to satisfy the same, to attach any debt or other property incapable of manual delivery due or belonging to the person liable or that may become due to him before the expiration of the calendar year." By means of such attachments in the hands of employers and others, many poll taxes which would not otherwise be collectible are paid. But even with the aid of this device the tax is poorly collected. The auditor in his report for 1896 estimates that only two thirds of the whites and one half of the negroes above the age of twenty-one pay poll taxes. So difficult is the collection of this tax that in 1897 the General Assembly enacted that persons or corporations failing to pay any tax laid on them by law shall be guilty of a misdemeanor and punished by a fine not exceeding $500 or imprisoned not exceeding six months. This law was aimed, of course, at the man without property, the citizen who is liable only to the poll tax. Taxes due by any citizen with property are collectible without fines or imprisonment. It is quite possible that this act did not fall within the constitutional provision prohibiting imprisonment for debts, but the law does not seem

to have been practicable and was repealed by the General Assembly of 1899.

The amount raised by the poll tax is next in amount to that raised by the general property tax. In 1898 the return from state and county poll taxes amounted to $365,738.27, or nearly one half of the sum raised for public schools, exclusive of sums raised in the larger towns for graded schools. Besides the poll tax levied by state and county, incorporated towns also impose poll taxes in North Carolina. In some cases, in fact, in most of the larger towns, the municipal poll tax is far in excess of the combined state and county poll tax.[1]

Criticism.—The poll tax of North Carolina is clearly a regressive tax of a very heavy kind. It amounts frequently to doubling the rate on small property owners. Let us suppose, for instance, two property owners, one owning property worth $10,000 and another owning property worth $300. If we levy on each a property tax of $1\frac{2}{3}$ per cent (an average municipal tax in North Carolina) and a poll tax of $5, this amounts to taxing the richer man at a rate slightly above $1\frac{2}{3}$ per cent, while the poorer man has to pay a $10 tax, or at the rate of $3\frac{1}{3}$ per cent. If a poor man has no property and thus escapes the payment of the poll tax the very existence of this tax is an inducement to him never to acquire any property, since from his first savings, the state, county, and city take away as much as the savings bank would pay him, if he had $300. If he only saves $100, they take far more than such a bank would pay him. That this is a real and an important consideration is revealed by statistics from Wake County given by the auditor in his report for 1896. Over 60 per cent of the taxpayers of this county pay on less than $500 of real and personal property, and the auditor estimates that 80 per cent of the taxpayers of the entire state pay on less than $500 worth of property.

On such persons the poll tax weighs heavily. The richer man does not feel it, the man with no property largely escapes it, but upon the small property owner it hangs like an incubus.

[1] The rates in some of the largest cities in North Carolina are as follows: Raleigh, $3.70; Winston, $4.05; Charlotte, $3; Wilmington, $3.96. These are the municipal poll taxes; to them must be added the state and county taxes, nearly always equal to $2.

It is not a tax proportioned to ability. It is not even, according to the theory of the general property tax, proportioned to wealth. In what manner its advocates would justify the retention of the tax is not clear. To most people who favor poll taxes, the old idea of paying the state for a service rendered, probably constitutes the best argument in its behalf.

As has been said above, the poll tax is mandatory and no General Assembly can refuse to levy it. There is urgent need of a change in the constitution permitting the tax to be laid only on persons not paying an equal sum on property. While such a tax would be theoretically far from a just tax, it would yet be an improvement on the present system and would lift the dead weight which hangs so heavily on the small property owner.

38. The Poll Tax in Mississippi and Georgia. — In other Southern states poll taxes have retained considerable financial importance. Dr. C. H. Brough writes as follows concerning poll taxes in Mississippi:[1]

Although Mississippi is aristocratic in its economic substratum, its attitude in regard to the poll tax has always been democratic. The landowners never objected to bearing the burdens of this tax, and they used it as an instrument to encourage slavery. This was accomplished, as we have seen, by a discrimination in the rate charged "free males of color" and white males. After the abolition of slavery and the enfranchisement of the freedmen, this discrimination was abolished and a uniform rate levied without regard to color or previous condition of servitude. The poll which, during the reconstruction period, was as high as $6 *per capita*, is now fixed at $2, and is imposed on all males between the ages of twenty and sixty years.

The importance of the poll tax in Mississippi may be appreciated from the fact that it is the principal fiscal device of the school districts in the state during the four months' public school term. Furthermore, the payment of the poll tax is made an implied condition of suffrage by that provision in the state constitution requiring two years' residence and the payment of all

[1] Studies in State Taxation.

taxes during that time, as two of the necessary qualifications of an elector.

No concealment need be made of the fact that the poll tax is used in Mississippi as a means of disqualifying the negro in national elections and controlling his vote in local elections. That the poll tax is more important in the state as an adjunct of suffrage than as a source of revenue is revealed by the fact that in 1897 out of a capitation of $529,694, only $250,057 was collected. Property owners are willing to pay a penalty for their ownership of property, in order to maintain white rule to protect their property. However barbarous the poll tax may be as a fiscal anachronism, social conditions in Mississippi are not yet ripe for economic reform in this direction.

And of the poll tax in Georgia, Dr. L. F. Schmeckebier writes:[1]

Capitation taxes yield the second largest amount derived from taxation. Every male inhabitant of the state, between the ages of twenty-one and sixty years, is subject to a poll tax of $1 per annum. Blind persons, cripples, and maimed and disabled confederate soldiers are exempt from this tax. No city or county, or any other corporate authority, is allowed to assess or collect any capitation tax whatever, except a street tax, and that after an opportunity is given to work upon the streets. The payment of the poll tax is requisite for the exercise of the suffrage, and this is a source of political demoralization. The negro especially refrains from paying his poll tax, and waits for the politician to pay it for him, which is ordinarily done. There is no way of enforcing the collection of the tax from persons who do not own property, except as a qualification for voting, and thus the tax always tends to fall on those who already own property. Furthermore the constitution of the state requires that a voter shall have paid all taxes required of him since 1877. Thus payment for the current year is not sufficient to qualify, but the voter must pay all taxes in arrears. There is a large class of citizens who sometimes pay and sometimes do not, and when they do pay, they do so merely for the purpose of voting. But

[1] Studies in State Taxation.

before they can do this they must register and swear that they have paid all taxes since 1877, and hence the tax is a constant incentive to perjury. The pernicious effect of such a system hardly needs any comment. About 60 per cent of the tax is generally collected. The census of 1890 showed a voting population of 398,122 and the yield of the tax in 1898 was $234,431.99. The proceeds are used "for educational purposes in instructing children in the elementary branches of an English education only."

CHAPTER XI

THE GENERAL PROPERTY TAX

39. The Conclusions of the New York Tax Commission of 1871 and 1872. — The chief financial resource of American states has for a long time been a general tax upon all property[1] within the reach of the taxing power. This general property tax, as it is called, has never worked satisfactorily, and its shortcomings have led to the appointment of numerous tax commissions[2] to investigate the problem of state and local taxation. The reports of some of the more important of these commissions are valuable sources of information concerning the workings of the general property tax. Our first selection is from the Second Report of the Commissioners appointed to revise the Laws for the Assessment and Collection of Taxes in New York[3] (1871 and 1872):

The property of New York, made subject to taxation, divides itself into two classes, *real* and *personal.*

Real Property, embracing, according to the usual acceptance of the term, lands and buildings, being visible and tangible, presents no inherent difficulty in the way of ascertainment, valuation, and assessment. The New York system of taxation in respect to these objects might, therefore, be reasonably supposed to work with some degree of uniformity and equality; but so far from this being the case, it would be difficult, nay, probably impossible, to find any two contiguous towns, cities,

[1] Certain exemptions are granted, however, to property used for religious, benevolent, or charitable purposes.

[2] The work of such commissions is described by J. W. Chapman, State Tax Commissions (Baltimore, 1897).

[3] The Commissioners were David A. Wells, Edwin Dodge, and George W. Cuyler.

or counties in the state, in which the valuation of such property approximates in any degree to uniformity. So far as the commissioners can ascertain, the average aggregate valuation varies from 20 per cent of actual value as a mininum, to 50 per cent as a maximum; with a probable total average for the whole state of a rate not in excess of 40 per cent. The lowest valuations, furthermore, do not, as might be supposed, occur in the poorest and most sparsely settled counties of the state, but rather in the richest and most densely populated; and it is also curious to note, that comparing the real estate valuations of the several counties of the state in the years 1860 and 1870, with the census returns of their population at the same periods, it will be found that some counties which have increased their population and railroad facilities, have decreased their valuations, while other counties, which have actually diminished in population, have increased their valuations.

The increase in the assessed valuation of the real property of the entire state for the ten years, from 1861 to 1870 inclusive, was $47\frac{1}{2}$ per cent; but deducting the valuations of New York and Kings counties, the increase was only $8\frac{1}{2}$ per cent, although the increase in the population of these two sections, during the same period, was not very unequal; the increase in New York and Kings counties having been 269,722, and for the remainder of the state, 232,301. Now as the law of the state is clear and explicit, that the valuations shall be uniform, it is evident that the law in this respect has become a dead letter and wholly inoperative.[1]

[1] In their First Report, submitted in 1871, the Commissioners give the following account of the methods of assessing real estate:

"In New York the state tax is apportioned among the counties on the basis of their respective valuations of real estate, and the same rule prevails among the towns of the different counties. Hence arises the double competition between the assessors of counties in the aggregate, and of the towns in each county, for the lowest possible valuation. Having completed his official labors, each assessor in the state subscribes an oath, of which the following is the material portion:

"'We do severally depose and swear that we have set down in the foregoing assessment-roll all the real estate in ——, according to our best information, . . . and that we have have estimated the value of said real estate at the sums which a majority of the assessors have decided to be *the full and true value thereof, and at which they would appraise the same in payment of a just debt due from a solvent debtor.*'

"And the law further provides 'that every assessor who shall willfully swear false in taking and subscribing said oath, shall be guilty of and liable to the penalties of will-

But if such be the inequality and illegality of the methods of taxing *real property* at present followed in the state of New York, the results which have attended the attempts to tax *personal property* under the same system are infinitely more farcical and disgraceful. The evidence of this failure is most conclusive, and the reasons why, under the existing system, nothing but failure in respect to the taxing of this description of property can be anticipated, are of a character that admit of being readily understood and verified. Thus the total equalized valuation of all the property of the state of New York for the year 1871–72 is $2,076,454,000, of which but little more than one fifth (21.48 per cent), or $445,918,000, was returned under the head of personal property.

In their previous report the commissioners presented evidence tending to show that the aggregate value of the real property of the state and the aggregate value of its personal property closely approximated. They furthermore presented a schedule of property of the class *personal* within the state, founded on exact data, or careful estimate, whose aggregate amount nearly equaled in value the entire amount of all the property of the state, real and personal, returned for taxation during the year 1870–71. They would also recall the opinion authoritatively expressed in the constitutional convention of 1868, that 30 citizens of the state could be named whose aggregate wealth (mainly personal) was very considerably in excess of the valuation for that year of all the personal property of the entire state. But without again entering into details, the commissioners would now say, that another year's experience has led them to this general conclusion, that the authorities of the state, under a law

ful and corrupt perjury.' Let us now see what are the acknowledged facts in respect to the valuation of real property in New York, and some of the other states, where a substantially like oath is made imperative.

"In some instances in New York the valuation of real estate for taxation is reported as low as 20 per cent of its real value. In a majority of cases in the country the rate varies from 25 to 35 per cent, and rises in the cities to 50 and possibly 60 per cent as a maximum. In short, there cannot probably be found a single instance in the whole state, unless possibly in the case of certain unoccupied lands, the property of non-residents, where the law as respects the valuation of real property is fully complied with, and where the oaths of the assessors are not wholly inconsistent with the exact truth."

(professedly executed) requiring the assessment of *all* personal property at its full value, do not in fact succeed in assessing a proportion equal to 30 per cent of the recognized *low* valuation of the real estate; or more than 15 per cent of the *real and true* value of all such property immediately located within the state, and as such subject to the state authority. So much in proof of the evidence of the failure of the existing laws relative to local taxation to do what they were designed and purport to do. So much also in evidence that the existing system of local taxation, by its own gravitation and surrounding influences, has, with the exception of incorporated capital, practically come down to a tax upon real estate.

The reasons why nothing but failure in respect to the valuation and assessment of personal property under the existing system can be anticipated are in the main as follows:

In the first place, much of the property termed "personal," and which under the system operative in New York and most of the other states it is made obligatory on the assessors to value and assess, is incorporeal and invisible, easy of transfer and concealment, not admitting of valuation by comparison with any common standard, and the *situs* or locality of which, for purposes of assessment and taxation, involves some of the oldest, most controverted, and yet unsettled questions of law. Of such a character are all negotiable instruments, *i.e.*, national, state, municipal, and corporate bonds; written obligations of indebtedness on the part of individuals; book accounts, annuities, money at interest, cash on hand, and the like, the whole constituting by far the largest proportion of the so-called personal property of the country.

It is obvious, therefore, that the law contemplates the doing of an act; namely, the valuing and assessing of that which is invisible and incorporeal, which cannot be done without the fullest coöperation, through communication of information, of the taxpayer himself; and yet for the imparting of which the two most powerful influences that can control human action, namely, love of gain, and the desire to avoid publicity in respect to one's private affairs, coöperate to oppose.

And in the case also of much of the so-called "personal property" that is visible and tangible, as furniture, books, works

of art, jewelry, musical instruments, and the like, it is clear that its valuation, with any approximation to fairness, must be not only the work of time, but must require an amount of experience rarely in the possession of any one individual.

Whenever, therefore, a system contemplating the taxation of personal property, generally, has been projected, its authors have been led, as it were by instinct, to the conclusion that its execution with any degree of effectiveness must depend upon the employment of extraordinary and arbitrary measures. Thus, the old Romans, who first established the taxation of personal property at the period of the decadence of the empire, and who were not troubled with any restrictions of a constitutional character, or any very nice notions about personal liberty or general morality, clearly perceived this, and accordingly invested their tax officials with the power of administering torture as a means of compelling information and enforcing payment.

The board of officials of Illinois, who last year, under authority, prepared a new tax code for their state, and based their work on the hypothesis that the only way to make a better system was to enlarge and make more effective the old, also perceived this; and accordingly prepared a code, which one of the highest authorities in that state characterized in the following language:

> "Without exception it is the most objectionable law that was ever proposed, and we can imagine no act which will become so justly odious and detestable. It provides for the establishment of a distinct branch of the government, which may be properly styled the grand inquisitorial and confiscatory office, clothed with powers and functions, which, if enforced, would have produced a revolution in Austria or Turkey." — *Chicago Tribune.*

The officials of the state of Massachusetts, also, in attempting to carry out a system which provides for the valuation of that which is intangible, and the assessment of what is invisible, acknowledge the necessity of the employment of extraordinary measures, and accordingly resort to a method of procedure which has no parallel except in the records of the Middle Ages and of the Inquisition, and constitutes, in itself, a satire upon any claim to the enjoyment of a wholly free and enlightened government. For, failing to obtain satisfactory information about the private affairs of any individual, the chief assessors

and their subordinates, to the number of some fifty, meet in secret session, in a large upper chamber set aside for the purpose, and appropriately termed the "dooming chamber," when the citizen in question, without being present either by counsel or in person, is arbitrarily doomed to the payment of any sum which a majority of those present may think proper; and from which "dooming" there can be no appeal.

Now the old pagans, the officials of Illinois, and the Boston assessors, have undoubtedly been consistent in following the only line of action calculated to render their ideas of raising revenue by taxing all descriptions of property, in any degree effective; and the people of the state of New York ought clearly to understand that the same course is the only one open to them, which can, by any possibility, make their existing system anything different from the farce which every intelligent person must acknowledge that it now is.

40. The Report of the Maryland Tax Commission of 1888: the Supplementary Report of Professor Richard T. Ely. — In 1886 Maryland appointed a commission which two years later submitted an important report, the most valuable part of which was a supplementary report by Professor Ely, one of the members of the commission. Professor Ely gave the following account of the working of the general property tax in Maryland and other states: [1]

Our Present System of Taxation

Our present system of state and local taxation is unsatisfactory. This is recognized universally, and it is on this account that the present commission was appointed. What our existing system of taxation is, is well enough known, and is in fact so simple in its main features that it can be stated in a single sentence. The fundamental idea in it is this: Everybody should contribute to the support of government in proportion to capacity, and capacity is determined by one uniform tax on the assessed value of all property, of every description whatsoever.

[1] Report, 96–103. These views Professor Ely repeated in his Taxation in American States and Cities (1888).

This is the main feature of our existing system of taxation in the state of Maryland, and in the various political units embraced within the state; yet there are other important taxes and some other sources of revenue. Licenses, especially on traders and oyster houses, yield a considerable sum to the state; taxes on commissions of executors and administrators, on collateral inheritances, and on gross receipts of railroad companies, are items of note in the comptroller's statement of receipts into the treasury of the state; while dividends on stocks are by no means insignificant. The budgets of the cities are similar to those of the state. Baltimore receives large sums from licenses, from rent of property, from dividends, from the special tax on gross revenues of street railways; but in the case of the local political units, like the state, the leading feature is the one uniform tax on the assessed value of all real and personal property, excluding of course that exempted by special legislation or constitutional provision.

Origin of our System of Taxation

This system of taxation originated at an early period, and has, at one time or another, doubtless been in vogue in nearly every civilized nation. It has, however, been abandoned in all countries except the United States, as antiquated; in several of our commonwealths, a tendency to change our system of taxation is already manifest; and everywhere dissatisfaction with it is so marked that there is constant inquiry for better financial methods, and special commissions are frequently appointed to investigate the subject of taxation. The reason for this condition of things becomes evident upon reflection. When our present rule of one uniform tax on all property was introduced, the wealth of the country consisted almost exclusively of real property, and of such personal property as would come under the head of visible, tangible chattels — property which could not readily be concealed.

Cattle, horses, and farming implements of one kind and another comprised a large portion of the personal property. It was very easy to assess to each man all his property, and to tax all in proportion to ability to pay taxes. This was then easier

for landed property than now, as owing to its comparatively small value and uniformity, it answered practical purposes fairly well to divide it into a few classes and to tax each at one uniform rate.

This method of taxation obtained in Ohio from the year 1800 to 1825 inclusive. Land was divided into three classes, according to "quality," and there were three rates of taxation per hundred acres: one for land of the first quality, another for land of the second quality, and still another for land of the third quality. These rates in 1800 were $0.85, $0.60, and $0.25 per hundred acres, according to quality. The rates in 1825 were $1.50, $1.12½, and $0.75 respectively. During this period the highest rates are found in the year 1816, when they were $3.75, $3.00, and $2.00, respectively.

The history of Connecticut illustrates an analogous but somewhat different method. It was the practice in that commonwealth, from the earliest colonial times until the adoption of the state constitution in 1819, to follow the plan still in vogue everywhere in Europe, and also in the city of Quebec, Canada, of basing taxation, not on the selling value of property, but upon its probable net revenue. We tax property now in our American commonwealths on the selling value of property; but the European system and the old Connecticut system were to estimate income itself, directly. It was also the practice in Connecticut to estimate the annual income of those pursuing any trade or occupation, and to tax them accordingly. The plan is described in the following words of the Report of the Special Tax Commission of Connecticut, made in January, 1887:

Those pursuing any trade or profession were assessed on an estimate of their annual gains. Real estate was rated, not according to its value, but in proportion to the annual income, which, on the average, it was deemed likely to produce. Lands as distinguished from buildings were put in the list at a fixed rate for each kind, prescribed by statute. The best meadow land went in at $2.50 an acre; plow land at $1.67; pasture at $1.34; wood lots at $0.34, etc.; not because those sums were deemed to be the value of the lands, but because they were thought to represent the average income they would produce. Houses and other buildings were likewise listed at fixed sums, determined by their size, materials, number of fireplaces, etc., but all described by the statute itself, and beyond the control of the assessors. Under such a system there was little opportunity for evading taxation. The acreage of each

farm, the general character of each lot, and the dimensions, use, etc., of each building, were readily ascertained, and the law then fixed the rate of assessment.

A somewhat similar system obtained in New Hampshire in early days. Specific taxes were imposed on polls, slaves, horses and neat cattle, and on land; orchards were taxed one shilling an acre, "accounting an acre so much as would produce ten barrels of cider." Arable land was taxed eight pence an acre, and an acre was regarded as a sufficient quantity to produce twenty-five bushels of grain; pasture land was taxed three pence an acre, and the quantity sufficient to summer a cow was to be considered four acres.

One member of our commission, Mr. James Alfred Pearce, tells me that in Kent County land is still divided into three classes, and that a fixed valuation is placed on each acre within a given class. I am unable to say whether this obtains elsewhere in Maryland or not. It appears, however, to be customary in Kent County, and also in other parts of the state, to return horses and cattle at a certain definite valuation for each, regardless of actual selling value.

The illustrations given are sufficient to show early methods of assessment. These obtained at one time or another nearly everywhere in Western Europe and in America, but it is needless to multiply examples in this place. The reasons why these methods were abandoned are sufficiently evident. They were adapted only to a primitive condition of society. When the classes of wealth became more numerous, and when the differences in value between articles of the same class became more important, when one acre of land was often worth ten or twenty times, or even fifty times, as much as another situated in the same commonwealth, there could not fail to arise a demand for a system of taxation which would adjust the burdens of the government more accurately and make them bear upon each individual more nearly in proportion to his ability. It seems that our present system of taxation arose with this in view, and in our older American commonwealths, very generally, early in the present century; while the newer states simply copied the institutions of the older.

Dissatisfaction Early Manifest

The existing method of assessing and taxing property was better adapted to the first half of the nineteenth century than to the second half, for property could then generally be found. Early in this century it should be remembered there were comparatively few banks; there was not a single railroad company, and of course none of that mass of easily concealed property based on railways, such as stocks and bonds; there was not a telegraph or telephone company, nor were there any traces of that property which consists of their evidences of indebtedness; there was not one gas company; and the manufacturing corporations of our day had scarcely begun to exist. Is not this sufficient to show the difference between the requirements of a rational system of taxation in the one period and in the other?

Nevertheless, it appears, as so often happens, that while the end sought was commendable, and this end was the realization of democratic principles in taxation, the means used for the accomplishment of that end were inadequate. Dissatisfaction was soon manifest on account of inequalities in the adjustment of the burdens of taxation, and attempts were made to remedy this.

This dissatisfaction has increased without interruption up to the present time, and every year renders our existing methods of assessing property and of taxing it more intolerable. The endeavors to improve upon actual methods have been frequent and are daily increasing in frequency, but they usually prove fruitless or render a bad matter worse, because those who make them have failed to go to the root of the evil, which is the system itself. The truth is, the existing system is so radically bad, that the more you improve it, the worse it becomes. This lies in the nature of things, and nothing any legislature can do, can alter this condition of things. Experience and reason alike teach this, and in my opinion place it beyond controversy for all those who have eyes to see what is passing about them every day of their lives.

There was comparatively little personal property in existence one hundred years ago. Only in the present century has that species of property, at first gradually, then very rapidly, assumed

the enormous proportions to which we are now accustomed. This growth has accompanied the development of cities, which are the home of invisible personal property. Where the population is chiefly rural, there can be comparatively little personal property, and a large part of what does exist is visible and easily found.

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Personal property has increased relatively more rapidly than real property, until now it is regarded as its equal in value in most of our American commonwealths. This would seem, however, to be a low estimate, if we may regard the estimate of an English writer on finance, in regard to England, as at all trustworthy, for as early as 1869 he estimated the value of personal property in England at *double* that of real property.

The Nature of the Difficulty

The reason why our present system of taxation does not operate satisfactorily can be stated in a word: although it is on the face of it fair and simple, it is found in practice to be an impracticable theory, for a large portion of property escapes taxation, and that the property of those best able to bear the burdens of government, namely, the wealthy residents of cities. On the one hand, it is impossible to find this property, and to force men to make returns under oath results invariably in perjury and demoralization, without discovery of property; on the other hand, federal laws, over which our states and municipalities have no control, enable many to escape taxation by investments, often temporary, in federal bonds, exempt from taxation.

Personal property is sometimes discovered in its entirety, but it is then nearly always the property of the comparatively helpless, namely, widows and orphans, whose possessions are a matter of public record. Less often a burden is imposed upon the conscientious. Thus, I happen to know of one wealthy town of a few thousand inhabitants, where three men of conscientious convictions with regard to a man's duty to the commonwealth, pay taxes on their personalty, although they have as good an opportunity to escape as others. This state of things naturally produces dissatisfaction on the part of farmers

and other hard-working people, who feel that personalty ought to bear a share of the burden of taxation. On this account they suggest various things, like taxation of mortgages, and a more vigorous search for hidden property. Their aim, as I have said, is commendable; but to attempt to reach the desired goal by direct means, under existing laws, or any laws which do not imply a change of the system of taxation, is as Utopian as the dream of the most radical socialist.

41. The Report of the Massachusetts Commission of 1897. — More recently a Massachusetts commission[1] has presented a very careful statement of the working of the general property tax in that state. The extracts here presented relate, first, to the requirements of the existing laws, and, second, to the practical working of the tax system.

I. THE EXISTING LAWS[2]

The commonwealth of Massachusetts subjects to taxation "all property, real and personal, of the inhabitants of the state not expressly exempted by law."[3]

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Real estate, for the purposes of taxation, includes all land within the state and all building and other things erected upon or affixed to it. It is taxable where it is situated, irrespective of the domicile of its owner.

For the assessment of real estate the law makes a somewhat different provision than for the assessment of personal property. The assessors are called upon to demand of the taxpayers a sworn list of their personal estate. But no such requirement is made by law as to realty. The assessors, when entering on the process of assessment, may or may not require the inhabit-

[1] The majority report of the commission, from which the extracts are taken, was signed by James R. Dunbar, Alvan Barrus, T. Jefferson Coolidge, and Professor F. W. Taussig.

[2] Report, pp. 5–13.

[3] The principal exemptions are: property of literary, benevolent, charitable, and scientific institutions; houses of religious worship; wearing apparel, farming utensils, and mechanics' tools not exceeding $300 in value; also certain exemptions for dependent and indigent persons. — ED.

ants to bring in a list of their real estate subject to taxation. If they make no such requirement, the taxpayer incurs no direct penalty for failure to list his realty. The assessors estimate its value and assess it accordingly; and in such case, although having made no return of his realty, the taxpayer, if dissatisfied with the assessors' valuation, may thereafter file a list and make his own valuation under oath, and will then be entitled to abatement if erroneously assessed.

An important part of the method of taxing real estate is the treatment of mortgaged property. It is often stated that mortgages on Massachusetts real estate are exempt from taxation; but this, while it may express the usual outcome of the statutes, does not state their exact provisions. Strictly, the legislation is designed to bring about one tax on the real estate, and one only, whether it be mortgaged or not. It applies, moreover, only to mortgages on taxable real estate; hence it does not apply to mortgages on realty situated outside of the commonwealth, or on real estate situated within it but exempt from taxation (as, for example, mortgages on church property). Mortgages on such real estate not taxable by the commonwealth are taxable as personal property to their holders. As to taxable realty, either the mortgagor or the mortgagee may bring to the assessors of the town where the mortgaged real estate lies, a statement of the amount of the mortgage and the name and residence of every holder of an interest therein as mortgagee or mortgagor. If this be done, the mortgage is taxed to the holder, usually at its face value, but not to an amount exceeding the fair cash value of the mortgaged premises. The mortgagor, however, is usually under no inducement to make a return, stating the mortgage on his property and the extent of his equity. He would have such an inducement only if taxes on the mortgage thereby became chargeable not to himself but to the mortgagee. Mortgage deeds, however, are invariably drawn so as to stipulate that the mortgagor shall assume all taxes. The mortgagor consequently has no inducement to declare the mortgage. The outcome of the legislation is thus that but one tax is levied on the real property, and that the mode of payment of this one tax is left to be adjusted between the mortgagor and the mortgagee in such manner as they may agree. In practice, the mortgagor

or borrower agrees to pay the one tax, and contracts his loan with the mortgagee or the lender on this basis. Whether the arrangement has proved to be expedient and just is a question as to the working of the tax system, which, in common with all other such questions, we shall postpone for examination in the second part of our report.

The total valuation of real estate assessed for taxation in 1896 was $2,040,200,644. The total amount of taxes assessed upon real estate in 1896 was $30,120,730.[1]

As to personal property, the mode of assessment is, under the letter of the statutes, different from that as to real property. The assessors are directed to require all inhabitants to bring in true lists of all their polls and personal estate. They are to give seasonable notice that they are about to make an assessment, and in such notice are required to demand lists of personal property. But if the taxpayer fails to comply with the requirement, he is subjected to no direct penalty. The assessors, in case of failure, are to ascertain as nearly as possible, according to their best information and belief, the particulars of the personal estate. The statute calls for no special pressure or punitive estimate by the assessors as to the taxpayers who have made no return; it calls only for an estimate at just value, according to best information and belief. From the tax assessed on this estimate, however, the taxpayer may be allowed an abatement only in case the tax exceeds by 50 per cent the amount which would have been chargeable if a return under oath had been seasonably made, and only the excess over this 50 per cent may then be abated. The penalty for failure to make a return thus is only the indirect one of a limitation of the amount of abatement if the tax by estimate proves to be heavier than the tax would have been in case of a return.

It should be observed, further, that the assessments made by the assessors, whether on the basis of return or of estimate, are to be kept open to public inspection. Strictly speaking, they may be examined only by property holders (whether resident or non-resident), these having free access to them at all times. Practically, whatever assessments are made by the assessors,

[1] For 1904 the total valuation of real estate was $2,555,300,000, and the taxes assessed upon it were $41,575,000. — ED.

whether by estimate or by return, are thus published to all the world.

The law defines with much detail what is personal property for the purposes of taxation. Without following the precise order of the enumeration made in the statutes, we may classify the taxable personal estate under the following heads: (1) "Goods, chattels, money, and effects, wherever they are, ships and vessels at home or abroad"; with the exception, however, that vessels engaged in the foreign carrying trade are taxable only for the net yearly income paid out to the owner in the way of dividends. (2) "Money at interest, and other debts due the persons to be taxed more than they are indebted or pay interest for." Debts secured by mortgage on taxable real estate are expressly declared to be not included in such taxable debts. On the other hand, indebtedness on mortgage may not be used by the debtor to reduce the amount for which he may be taxable on account of debts due to him. Barring this exception as to mortgage debts, debts due to the taxpayer are taxable, but may be offset to the extent of indebtedness owed by him. In no other way is allowance made in the statutes for a taxpayer's indebtedness. (3) "Public stocks and securities, bonds of all railroads including street railways, stocks in turnpikes, bridges, and moneyed corporations, within and without the state." But shares in corporations chartered by the state or organized under its general laws are not taxable to the holder for state, county, city, or town purposes. They are taxable for school district or parish purposes, but this liability is practically of no moment. The taxation of the property of Massachusetts corporations is secured by the general franchise tax levied on them, which will be described under another head. There are some other minor exceptions to the general rule as to the taxation of securities to their holder, but these we will not stop to consider, as they do not materially affect the general tax system. (4) "Income from an annuity, from ships and vessels engaged in the foreign carrying trade, and so much of the income from a profession, trade, or employment as exceeds the sum of $2000 a year; but no income shall be taxed which is derived from property subject to taxation." Under this provision, incomes from a profession and from salaries are clearly taxable. A question has arisen, how-

ever, whether a tax is chargeable on the income derived by a business man from the use of property already subject to taxation. At one time it was a practice among assessors, in administering the tax on income from trade and business, to make allowance for the taxes already assessed on the property whose use in business gave rise to the income. It was assumed that the gross income from a business was to be regarded partly as interest on the capital engaged and already taxed, and partly as the result of skill and labor in management; therefore in part only as income from the trade, and not from the taxed property. The part of the income derived solely from the trade was regarded as taxable income. By allowing 6 per cent interest on the taxed business property, and by assessing the income tax only on the excess of what was earned from the business over and above this interest allowance, it was thought that the income from the trade was taxed in conformity with the statute; while by allowing for interest on the business property already taxed, there was no tax on the income derived from property subject to taxation. But a decision of the Supreme Court interpreted the statute to mean that all incomes from trade must be regarded as derived from skill and labor in management as well as from the use of capital, and that assessors must tax the whole income from a business, even though property engaged in it was already taxed.

Personal property is assessed in general to the owner at the place of his domicile. The statutes provide that, subject to certain important exceptions, to be presently considered, "all personal estate, within or without the commonwealth, shall be assessed to the owner in the city or town where he is an inhabitant on the first day of May." "An inhabitant," for the purposes of taxation, is a person having a domicile. A person is ordinarily an inhabitant, or is domiciled, where he has a residence. The fact of actual habitual dwelling in any one place during a great part of the year, including the date named in the statute, must be very strong evidence of domicile for the purposes of taxation.

The presumption that bodily presence at a particular date goes far to fix domicile is strengthened by another provision in the statutes relating to taxation. "A taxable person who is in a

city or town on the first day of May, and who, when inquired of by the assessors thereof, refuses to state where he considers his legal residence to be, shall for the purposes of taxation be deemed an inhabitant of that place. If, when so inquired of, he designates another place as his legal residence, said assessors shall notify the assessors of such place, who, on receiving the notice, shall tax such person as an inhabitant of their city or town. But such person shall not be exempt from the payment of a tax legally assessed to him in the city or town of his legal domicile." The statutes also provide for the punishment by fine of not less than $500 and not more than $5000 of any "inhabitant" of the commonwealth who escapes taxation by "willfully and designedly changing or concealing his residence."

There are important exceptions, however, to the general rule that personal property is taxable to the owner at his place of domicile. Certain specified kinds of personal property are taxed where they are situated, or where the business for which they are used is conducted: (1) "All goods, wares, merchandise, and other stock in trade (except ships and vessels owned by a copartnership), including stock employed in the business of manufacturing or of the mechanic arts in cities or towns within the commonwealth, whether such owners reside within or without the commonwealth, shall be taxed in those places where the owners hire or occupy manufactories, stores, shops, or wharves, whether such property is within said places or elsewhere on the first day of May of the year when the tax is made." That is, stock in trade is taxed where the business is carried on. This may or may not be the place where the owner lives, and may or may not be the place where the goods are situated. The owners may reside in another city or town of the commonwealth, or may reside in another state; the stock in trade may be situated in another city or town from that in which the premises of the business are; it is taxable where the owners "hire or occupy manufactories, stores, shops, or wharves." It is important to note, however, that these provisions do not apply to stock in trade owned by Massachusetts corporations; nor do they apply to stock in trade *not* "in cities or towns within the commonwealth." Stock in trade outside the commonwealth, owned by inhabitants thereof, is taxable to the owner at his domicile.

(2) "All machinery employed in any branch of manufactures shall be assessed where such machinery is situated or employed." This holds good of the machinery owned by corporations, as well as of that owned by individuals and firms. Machinery is thus treated precisely like real estate; it is taxed where it is, whether the owner lives within the same town or within the state. (3) "Horses, mules, neat cattle, sheep, and swine, kept throughout the year in places other than those where the owners reside, whether such owners reside within or without the commonwealth, and horses employed in stages or other vehicles for the transportation of passengers for hire, shall be assessed to the owners in the places where they are kept." (4) "All personal property within the commonwealth leased for profit shall be assessed for taxation in the city or town where such property is situated on the first day of May to the owner or person having possession of the same."

As to these sorts of tangible and visible personal property the statutes thus depart from the rule that personalty is taxable to the owner at his place of domicile. They are taxable, either where the business is carried on, or where they are situated, or where they are kept, whether the owners reside within or without the commonwealth. But property of this sort not within this state is treated according to the general rule; if it belongs to an inhabitant of the commonwealth, it is taxed to him at his domicile. The same general policy is followed in regard to another form of personal property, — ships and vessels. "Ships or vessels owned by a partnership shall be assessed to the several partners in their places of residence, proportionally to their interests therein, if they reside within the commonwealth; but the interests of the several partners who reside without the commonwealth shall be assessed to the partnership in the place where its business is carried on."

There are also special provisions relative to property in the hands of guardians, trustees, and the estates of deceased persons.

The total valuation of personal property assessed for taxation by the local assessors in 1896 was $582,319,634. The amount of taxes assessed upon personal property was $8,398,980.[1]

[1] For 1904 the total valuation of personal estate was $696,471,000, and the taxes assessed upon it were $11,096,971. — ED.

II. The Working of the Existing Tax System

A. *Taxes on Real Property*

In the actual operation of the tax system, the taxes on real property are by far the most important. Out of the total of taxes on property and polls assessed in the commonwealth during the year 1896, three quarters was raised by taxes on real estate.

Total tax assessed on polls and property, 1896 . . .	$39,954,339
Assessed on polls	1,434,629
Assessed on personal property	8,398,980
Assessed on real estate	30,120,730

We have noted the fact that the law makes provision for a certain discretion on the part of the assessors as to the methods of taxing real estate, and authorizes them to tax it by estimate rather than by return on the part of the taxpayers. In practice, the taxation of real estate takes place universally by estimate and valuation on the part of the assessors. We are glad to be able to report that this part of the tax system is in the main honestly and fairly administered. It would be going too far to say that the assessors of the several cities and towns are perfect, or to deny that grave mistakes are sometimes made in the valuation of real estate. But such difficulties as occur and such mistakes as are made are the result, not of the laws on taxation, but of defects in their administration. No method of taxation will work well which is not administered by competent and zealous officials; as, on the other hand, no method will work well which makes exceptional demands on the intelligence and character of the officials. So far as the taxes on real estate go, the law calls for no important amendments; if its administration is faulty, the remedy is to be found in greater diligence by the voters and by the appointing officers in the several cities and towns.

Nevertheless, there are important problems in connection with the taxation of real estate. In many farming towns of the commonwealth the burden of taxation on land is exceedingly heavy, and some measures of relief are called for. In many other parts of the commonwealth, and especially in the cities, the question

arises how far the taxes on real estate are definitively and finally paid by the owners on whom they are first levied, and how far they are shifted by the owners to tenants or to other persons, and so distributed in their ultimate incidence among the various classes of inhabitants.

The situation in many of the farming towns is peculiar. Here, without fault of the assessors or of the towns, and as a result mainly of general industrial causes, the burden of taxation on land is heavy, and in some towns extraordinarily and unfairly heavy. It is at this point that we find the working of the taxes upon real property most unsatisfactory. Some remedy is called for, though that remedy is to be found rather in a general readjustment of the burdens of taxation than in a change of the laws as to the taxation of real property.

In a considerable number of farming towns of the state, land is assessed at more than its selling value, and is, moreover, taxed at a high rate on this excessive valuation. Land is often assessed which, if put up for sale, would find a purchaser only at a price below its assessed value, if indeed it found a purchaser at all. In such towns the tax rate is often $16, $18, sometimes $20 and over $20 per $1000 on this high valuation. The taxes are excessively and unfairly heavy, as compared with the taxes on real property in other parts of the commonwealth.

The explanation of this state of things, as we have already said, is to be found not in defects of law, nor even in error or undue zeal on the part of the assessors, but in the general industrial situation. Agriculture in Massachusetts is a declining industry, — regrettably so, but undeniably so. The enormous cheapening of freight rates and the consequent competition of the West, the fall in the prices of transportable agricultural products, the growth of manufactures, and the attraction to the cities of a larger and larger proportion of the farming population, — all these causes have brought about a decline of the farming towns, a diminution in the profits of agriculture in Massachusetts, and a fall in the value of farming property. Land in the neighborhood of large cities and so having a good market for vegetables and milk, or land which is attractive for summer residents and of value on that account, has escaped the general decline; but in a town which has no such advantages of

situation or climate, agriculture declines, population is stationary or retrograde, and the value of the land tends to fall.

Such a town, however, is called upon now, as in times past, to maintain its schools, to repair its roads, to support its poor. It needs to raise larger amounts to meet the public charges now than it needed to raise thirty or fifty years ago. Its resources are less. The selectmen and assessors have the choice, if they wish, of lowering the valuation of farming land to the point of its actual selling value; but, if they do so, the only alternative is to raise the tax rate. Between a high valuation with a moderate tax rate, and a moderate valuation with a very high tax rate, the former course is naturally chosen. Hence, the tax rate in a farming town may not be high, or at least may not be so high as to attract special attention, while yet the real burden of taxation may be excessively heavy. The result is that the farmer in such a town is taxed very heavily in proportion to his real means. The difficulties of his situation are, it is true, largely due to causes beyond the control of the legislature. So long as the agricultural conditions remain what they are now, farming in Massachusetts cannot be a flourishing industry. But these difficulties at least should not be increased by the operation of our tax system; and we shall accordingly endeavor to suggest changes which will relieve the Massachusetts farmer from more than his just share in the burdens of taxation.

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As was pointed out in the first part of our report, the taxation of mortgages on taxable real estate is now treated by the statutes as part of the taxation of real estate. A piece of mortgaged real estate is taxed once for all, and the mortgagor and the mortgagee are allowed to arrange between themselves in what manner the taxes shall be met. The practical effect is that all mortgages stipulate for the payment of the tax by the mortgagor or borrower. The mortgagee is not directly affected by the tax, and may be said to be virtually exempted.

As to the effect of this arrangement, it is contended, on the one hand, that the result has been a decline in the rate of interest on mortgages, and thus a substantial relief to the borrowers; on the other hand, it is maintained that no decline in the rate of interest ascribable to this cause has occurred, and that the present

system inures solely and unjustly to the advantage of the lenders.

To understand the operation of the law as it now stands, it is necessary to recall the conditions under which it went into operation. The present method was adopted in 1881. Before that time both the mortgage note and the mortgaged property were taxable for their full amounts to their respective owners. But this taxation was carried out under important limitations. Savings banks, which are always large lenders on mortgages, were taxable then, as now, at a special moderate rate, the rate being in 1881 three fourths of one per cent on their deposits. A savings bank making a loan on mortgage was therefore taxed at less than the usual rate, and had an advantage over an individual making such a loan and paying the tax contemplated by law. But the individuals lending on mortgage were not certainly and unfailingly reached by the tax on their mortgages. It is doubtful whether they were taxed in any large number of instances. The taxation of mortgages was carried out by estimate and dooming, and with great uncertainty. A large proportion, probably the larger proportion, of the mortgage notes held by private lenders were not in fact taxed. Hence, even an individual, in lending on mortgage before 1881, would make his loan not with a certainty of paying a tax on it, but only with some risk of being assessed for taxation on account of it. The rate of interest demanded by him, therefore, was affected rather by a risk of taxation than by a certain and unfailing charge on his mortgage investment. The change in the rate of interest on mortgages which might be expected from the exemption (so called) of mortgages in 1881 could, therefore, be not a reduction by the average rate of taxation in the state (one and a quarter or one and a half per cent), but a much smaller reduction; perhaps, on the whole, in the case of private loans as well as in that of savings bank loans, a change equivalent to the abatement to savings banks, namely, three quarters of one per cent.

A reduction in the rate of interest on mortgages about to this extent, we believe, did take place. So much has been shown, we believe, in the statistics collected by those who advocated the change of 1881 and who now advocate the retention of the present arrangement. It is further indicated by evidence which

has been brought before us in our hearings. It is not to be questioned that the competition in mortgage investments has been greatly increased by the change in the law, and that the tendency has been for the rate of interest on well-secured mortgages to go down. Trustees and others formerly liable to taxation on mortgages, and so hesitating to make them, now compete for them actively, and are willing to accept a low rate of interest. Undoubtedly a general decline in the rate of interest for all investments has taken place during this period, which accounts in part for the lower rate on mortgages. But we believe that the change in the tax law made in 1881 has tended to bring about a decline in the rate of interest on mortgages, security being the same; and this decline has been as great as could be expected in view of the conditions prevailing at the time when the law was changed.

We say security being the same; because, where the solidity of the security has changed, this factor has inevitably affected mortgage loans, and must be taken into account in judging of the course of events since 1881. As it happens, much property which was good security before that date is no longer good. Especially in loans on farming real estate, the rate of interest has failed to decline, because the property has become less valuable and less easily salable than it formerly was. Twenty-five years ago savings banks were glad to make loans secured by mortgage of farm property; at present they are usually averse to doing so. In the hearings which we have held it has been testified that after the act of 1881 savings banks in some cases offered to reduce the rate of interest on mortgages on farm property, provided that one half of the principal were paid off. The debtor, however, found himself unable to obtain this half, by second mortgage or otherwise, because fresh loans on farming property had become hard to secure. The failure of the rate of interest to go down on farming property is due to the general change to which we have already referred, — the regrettable decline in agriculture through the greater part of the commonwealth. This change, coming into full operation during the same period in which the act of 1881 has been in effect, has obscured the general working of that measure, and has brought about the impression that no decline whatever in the rate of

interest on mortgages has ensued. The moderate general reduction which we have mentioned may be ascribed to the legislation of 1881. But unfortunately, in the case of farming property, the decline has been more than offset by the inevitable unwillingness of investors to increase or even to retain loans on farming security.

Whatever may have been the precise effects of the act of 1881, we are of the opinion that the general principle which underlies that act should be maintained; namely, that there should not be taxes both on the mortgage and on the mortgaged estate, and that there should be only one tax on the property, whether under mortgage or not. The only question can be whether the method adopted by the commonwealth for bringing about this end is the best one. The other feasible method is that followed by the state of California. There, also, but one tax is levied on the mortgaged property. The mortgagor, or borrower, is called on to state who is the mortgagee, and the amount of the mortgage; each is taxed in proportion to his interest in the property, and no agreement for payment of all taxes by the mortgagor is recognized. The effect of this arrangement, it appears, is that, while the lender is taxed on the full amount of his mortgage note, the debtor is compelled to pay a rate of interest higher by the amount of the taxes, and even by something more. As compared with other loans and investments in California, mortgages there usually bear 2 per cent additional interest. The additional interest so charged is higher than the tax rate, for the lenders on mortgages are able to secure not only enough to compensate them for the taxes imposed, but something more by way of insurance against possible future rise in the tax rate.[1]

[1] See the investigation of this subject by Carl C. Plehn, Ph.D., The General Property Tax in California. Publications of the American Economic Association, Economic Studies, Vol. II, No. 3, June, 1897. [Subsequently Professor Plehn made a careful statistical investigation of the rates of interest upon taxed mortgage loans in San Francisco and the rates on other loans, equally well secured, which were not taxed. His results were as follows: "In San Francisco the excess of mortgage interest over the market rate averaged 2.08 per cent for the 19 years, while the tax rate averaged $1.699 per $100 of assessed valuation. Briefly stated, then, the mortgage tax raises the rate of interest by a little over 2 per cent, but the tax amounts only to 1.7 per cent. The difference, which to be exact is .381 per cent, is the 'cost of shifting' which the borrower pays the lender in addition to the tax." *Yale Review*, Vol. VIII, 58. — ED.]

What the borrower gains through the payment of taxes on the part of the lender, he loses, and something more also, in the form of a higher interest charge.

We conclude that it is inexpedient to make changes in the legislation of the commonwealth as to the taxation of mortgaged property. In view of the experience of California, and of the general probabilities of the case, we believe that the taxation of mortgages by a certain and unfailing process would bring about a rise in the interest charge at least to the extent of the tax. The present method in this commonwealth has now been in effect for a long series of years, and agreements on the basis of it have been made to a great extent. It works, if not perfectly, at least smoothly and certainly. Changes in the methods of taxation should not be made unless strong cause for them can be shown, and great gains can be reasonably expected. If the present arrangement as to mortgages is defective, in that persons of means, lending on mortgage, do not contribute proportionally to the public burdens, the remedy should be sought, we believe, in other ways than by overturning a system to which lenders and borrowers alike have adjusted themselves. Such greater contributions from the estates of persons of means we believe to be called for; and legislation for securing them we shall recommend in the third part of our report.

B. *The Taxation of Personal Property*

The taxation of personal property involves the most difficult questions in the tax problems before the legislature. At the same time, it is the part of the tax situation as to which it has proved most difficult to secure information. We have found it impossible, within the specified time, and with the means provided by the law creating this commission, to ascertain all the facts which it would be desirable to have in discussing the taxation of personalty. But some important facts are easily ascertained from the official publications of the commonwealth. In regard to others, we have undertaken inquiries which have yielded new and useful information. A circular letter was sent to each of the thirty-two cities of the commonwealth, asking certain questions; among them, questions as to the number of persons assessed for property and for personal property, as to

the number of sworn statements handed in by taxpayers, as to the nature of the personal property taxed, and as to the amounts of the different kinds of personalty assessed by sworn statements and by assessors' doomage. No circular was sent to the towns; but, from returns made by the assessors of the towns to the tax commissioner, and on file at his office, similar information as to the nature of the taxed personalty was gathered. The figures secured by these inquiries are given in detail in the Appendix, and we shall have occasion in various parts of our report to refer to them. We shall here summarize briefly the important facts as to the taxation of personal property, derived partly from the regular official publications, partly from independent inquiry. Some of the facts are familiar, others are not so. We present them all, in order to give as complete an exposition as possible of the whole situation.

The first question that arises in regard to the taxation of personal property is how far it is based on sworn statements by the taxpayers, and how far on estimates by the assessors. In regard to real estate, it makes no great difference which method is resorted to; and, as we have seen, the statutes give the assessors an option as to requiring or not requiring a return of real property. But there is a wide difference between taxing personal property by estimate and by return; and the law makes a formal requirement for a sworn statement of the taxpayer's personal property, although unaccompanied by any direct penalty for failure to do so.

No information as to the actual practice in this important part of the administration of the tax laws was available in the published reports; and the circular sent to the cities of the state accordingly asked, among other things, what was the number of sworn returns received. While the information refers only to the cities, we believe that it gives a good indication of the general usage in the towns as well. Indeed, from testimony given before us orally, we infer that sworn returns are more often made in the cities than in the towns.

It appears that, in the year 1896, there were assessed for taxes on property in the thirty-two cities of the commonwealth 220,804 persons, including corporations. The total number assessed for taxes of any kind was much larger, namely 604,496;

but, deducting those assessed for poll tax only (383,692), we have the figures just given for those assessed on property. Of the 220,804 persons so assessed on property, the greater part were assessed on real property only. Those assessed on personal property numbered 82,211; while, among these latter, those who were assessed on personal property and on no other property numbered 51,817.

Compared with the total number of persons so assessed, we find that there were secured in these thirty-two cities 5075 sworn returns from individuals (not counting returns made by corporations and banks). Roughly, this means that taxation rested on sworn statements for no more than one sixteenth of the taxpayers assessed for personalty. If we compare the number of sworn returns with the taxpayers assessed on personalty only, we find a ratio of one to ten.

It does not appear whether any of the sworn statements came from taxpayers who declared that they had no personalty at all, and therefore would not figure among those finally assessed for personalty. But it makes no serious difference whether we do or do not suppose that some among those who made returns swore that they had no taxable personalty at all, and so did not figure among the taxpayers assessed for personalty. In any case, the number of those taxed by estimate or doomage is overwhelmingly greater than the number of those taxed by return. In round numbers, we may say that between 90 and 95 per cent of those taxed for personal property of any kind were taxed by estimate of the assessors, or by what is commonly described as doomage.

As between individual cities, an inspection of the detailed figures in the Appendix will show great differences. In some there are practically no sworn statements at all, in others an appreciable number are secured. The proportion of sworn returns to the number of taxpayers assessed for personal property is usually greater in those larger cities in which there are many persons of accumulated means, such as Boston, New Bedford, Newton, and Cambridge; though to this general statement Springfield and Worcester present exceptions. In the strictly manufacturing cities, such as Lawrence, Lowell, Fall River, and Chicopee, there are very few returns.

In general, it is clear that our present system, while in theory of law one of taxation according to sworn return, is in practice one of taxation by estimate of the assessors. Returns are rare. Some of those which come in are made by unusually conscientious persons, who conform at once to the demand made upon them for a return of their property, regardless of the practice of their neighbors. A considerable number are made by trustees, who have no such personal interest as their beneficiaries have in the amount of the taxes charged.[1] A large proportion of the returns (1108 out of the total of 5576 in the year 1896) is made after assessment; *i.e.* presumably as a means of reducing the taxes charged by the assessors on estimate. But the great mass of the taxpayers make no statement, and pay without further ado what the assessors have charged them by doomage.

The questions next in importance with regard to the taxation of personal property are as to the amounts assessed, and as to the nature of the personal property included in the assessment. The total amount of assessed personalty is regularly stated in the official publications of the commonwealth. But no information has been available as to the different kinds of personalty taxed. We have accordingly collected facts on this point both as to the cities and as to the towns. For the cities, the facts were secured through the circular of inquiry sent to them; for the towns, they were secured from the triennial returns made to the tax commissioner, and on file in his office. . . .

The total property, real and personal, assessed by the local assessors in 1896 was $2,622,520,278, of which $2,040,200,644 was real estate and $582,319,634 was personal estate. Roughly, personalty thus bears to realty on the average the proportion of one to four. But this proportion varies very much in the different cities and towns of the state. In the cities, the variations, while considerable, are usually due to obvious causes. In a manufacturing city, like Fall River, an unusually large proportion of personal property results from the valuation of machinery as personal estate; and this also helps to explain a large valuation of personalty in Lawrence, Lowell, and New Bedford. Cities like Chelsea, Everett, Malden, Medford, and Somerville

[1] A footnote explains that in Boston fully half the intangible personalty assessed by sworn returns was returned by trustees and guardians. — ED.

show a proportion of personalty much below the average, having few great manufacturing or business establishments, and being inhabited mainly by persons of moderate means. Boston, Cambridge, Springfield, and Worcester show about the same proportion of personalty as the average in the state.

Between the towns there are still greater differences. In some towns there is an insignificant proportion of personalty assessed. In four towns the personalty is less than 5 per cent of the total valuation (Revere, Winthrop, Hull, and Mashpee, in 1895); in a few more it is less than 10 per cent; and in a considerable number it is less than 15 per cent of the total. But the most striking cases are those where the proportion of personalty rises far above the average. In a few towns there is a remarkable accumulation of personal property. In sixteen towns in the state the personal property assessed by the local assessors forms 40 per cent or more of the total valuation; that is, the assessed personalty, instead of being much less in value than the assessed realty, is nearly or quite equal to it.

We now turn to the next point of importance, — the nature of the personalty assessed. In the circular sent by us to the cities they were asked to specify what amounts of tangible and of intangible personal property were assessed. The former class was described as including stock in trade, machinery, furniture and carriages, live stock, ships and vessels, and "other tangible personalty"; while the latter was described as including money on hand and at interest, securities and investments, income, and "other intangible personalty." Replies giving the desired information were received from all cities except Boston and Somerville. In the two latter cities the assessors' records unfortunately were not so kept as to make it possible to classify the taxed personalty. As to the city of Boston, we had to content ourselves with the meager information given below. Estimates of the amount of tangible and intangible personal property, based on the opinions of the assessors and on the returns from all the other cities, have been made for the cities of Boston and Somerville.

For the towns of the state the returns on file in the office of the tax commissioner make it possible to classify the as-

sessed personal property in a similar manner. The figures as to the cities relate to the year 1896, those for the towns to the year 1895. But this difference in date, a consequence of the different modes in which the commission found it necessary to procure the information, does not materially affect its pertinence for the general problems of the tax system.

In the cities (except Boston and Somerville) the assessed personalty was classified as follows:

Tangible personalty		
Stock in trade	$35,964,749	
Machinery	77,338,741	
Furniture and carriages	6,561,177	
Live stock	6,357,015	
Ships and vessels	1,872,658	
Other tangible personalty	1,669,197	
Total tangible personalty		$129,763,537
Intangible personalty		
Money on hand and at interest	$2,070,766	
Securities and investments	22,810,714	
Income	3,880,220	
Other intangible personalty	36,258,481	
Total intangible personalty		65,020,181
Total personal property		$194,783,718
Total personalty (including Boston and Somerville)		397,032,218

It will be seen that in the thirty cities (not including Boston and Somerville) the tangible personal property assessed was in the ratio of two to one to the intangible. Machinery is by far the largest item in the class of tangible personalty; next comes stock in trade; the other items are comparatively small. For the intangible personalty the classification evidently signifies nothing. Almost all the personalty of this sort is assessed by estimate or doomage in a lump sum, and is variously called "cash assets," "securities," "investments," "stocks and bonds," the separation of the various items being nominal. The only item which we may suppose to be really treated separately by the assessors is that of income. The figures under this head probably give some indication as to the independent yield of the tax imposed on incomes from trade and profession exceeding $2000 per year.

In Boston, the assessors, when estimating or dooming per-

sonal property, put down one lump sum, not distinguishing on their records what is the nature of the personalty estimated, whether machinery, stock in trade, cash assets, or other taxable personalty; hence it is not possible to secure from their records information such as is given in regard to other cities. In former years, and until 1894, the assessors in Boston published information as to the nature of the personalty taxed according to sworn returns. In the last year in which this information was published (1894) it appears that $38,312,800 of personal property, out of a total of $204,365,192, was taxed by sworn return made by individuals; and the sum so taxed according to sworn return was made up as follows:

Tangible personalty		
Goods, wares, and merchandise	$10,330,200	
Machinery and office furniture	902,000	
Horses and vehicles	443,700	
Household furniture	393,200	
Ships and vessels	51,600	
Tools	1,400	
Total tangible personal property returned		$12,122,100
Intangible personalty		
Bonds	$9,071,200	
Shares of foreign corporations	8,609,400	
Cash assets	3,572,600	
Money due in excess of debts due	2,524,500	
Mortgages taxable, etc.	903,900	
Income	742,100	
Money at interest	721,700	
Other intangible personalty	45,300	
Total intangible personal property returned.		$26,190,700

(The commission then proceeds to make an estimate of the comparative amounts of tangible and intangible personalty assessed by dooming in Boston, and comes to the conclusion that tangible personalty exceeds intangible, although perhaps to a less degree than in other cities.)

As is to be expected, in view of the small number of sworn returns, vastly the larger part of the personal property is assessed by estimate or doomage; and this holds good of both kinds, whether tangible or intangible. As appears from the

detailed figures, the amounts in twenty-eight cities (not including Boston, Lynn, Somerville, and Taunton) may be classified as follows:

Tangible personalty assessed	$121,563,754
(*a*) By sworn return	10,984,343
(*b*) By estimate of the assessors	110,579,411
Intangible personalty assessed	60,372,477
(*a*) By sworn return	7,311,778
(*b*) By estimate of the assessors	53,060,699

The situation in the towns is in some respects different from that in the cities, in some respects the same. Taking all the towns of the state, it will appear that the intangible personal property exceeds the tangible. But, putting aside a few towns in which the conditions are peculiar, and considering the great mass of towns, we find the same proportion as in the cities,—the tangible personal property is to the intangible personal property as two to one. It will be remembered that the information as to the towns was secured by compilation from certain returns made to the tax commissioner for a different purpose, which do not in all cases separate the items in the exact manner desirable for our inquiry. But the figures which we have compiled are, nevertheless, in their main results trustworthy and significant.

The following general figures give a summary statement of the situation in the towns:

	Tangible Personalty Assessed	Intangible Personalty Assessed	Total Personalty Assessed
All towns	$64,008,262	$83,792,441	$147,800,703
18 selected towns[1]	3,173,108	52,570,721	55,743,829
304 remaining towns	60,835,154	31,221,720	92,056,874

[1] The eighteen selected towns are: Arlington, Belmont, Brookline, Cohasset, Easton, Falmouth, Groton, Hopedale, Lancaster, Lincoln, Manchester, Mattapoisett, Milton, Nahant, Stockbridge, Swampscott, Wellesley, Weston. These eighteen towns include ten of the sixteen towns enumerated on another page as having an exceptionally high percentage of personal property in their valuation.

Intangible personal property crowds into a small number of towns; these, moreover, are, as a rule, towns of no very large population. These towns, less than 6 per cent of the whole number, have over 60 per cent of the securities, investments, cash assets, etc., assessed in all the towns, and over 25 per cent of such property assessed in the state. Having a population in all of 62,529, they have an assessed valuation of $52,570,721 of intangible personalty, or not much less than the total of such property assessed in thirty cities (not including Boston and Somerville) having a population of 1,086,647. In these few towns the intangible personalty enormously outweighs the tangible, as sixteen to one. But in the remaining towns of the commonwealth the conditions are similar to those in the cities, excepting Boston, the intangible personalty being to the tangible in the ratio of about one to two.

Out of the total of $147,800,703 of personalty assessed in the towns, $64,008,262 was tangible personalty, $83,792,441 was intangible. As in the cities, the most important single item of tangible personalty is machinery ($22,885,187); stock in trade stands next ($21,299,223), then live stock ($14,655,746), carriages ($4,107,315), ships and vessels ($949,158). Under the head of intangible personalty the largest item is that of cash assets and securities ($52,405,119). But here, as in the case of the cities, the precise designation given to the intangible property by the assessors is of very little value as a guide to the true amount of each particular kind of property actually reached. An exception may, however, be made to this general statement as to the item of income, a small amount in the towns ($1,529,705), which probably states the actual separate assessment of this part of the taxed "personal property."

From this summary of the available statistical material we proceed to a further consideration of the taxation of the several kinds of personal property.

The forms of personal property which are most regularly and unfailingly taxed are live stock in farming towns, and ships and vessels. In a farming town, it is as well known how many cattle a taxpayer has as how much land he owns. No sworn statement is needed, and few are made. The assessors, from

inspection and from verbal statements, ascertain what live stock each taxpayer owns, and assess him accordingly. Similarly, ships and vessels are easily and unfailingly taxed. The valuations of these forms of tangible personal property, and especially of live stock, vary in the different towns, some assessing them to their full market value, others assessing them less strictly. In the purely farming towns, the same tendency appears in the assessment of live stock as in that of real estate; in order to keep the tax rate from rising too high, the valuation is strict. The taxation of live stock in such towns is as certain and as burdensome as is the taxation of land there.

In the cities, and in the towns not mainly agricultural, the methods of taxing personal property of these kinds vary greatly. Sometimes the assessors count separately each horse, cow, carriage, or other visible piece of personal property; then adding, if they think there is cause, a lump sum for intangible property. Sometimes they simply estimate the whole of a taxpayer's personalty in one lump sum. The former method is followed, for example, in the city of Cambridge; the latter is followed in the city of Boston and also in the town of Brookline. These differences in three large adjoining places indicate how diverse is the working of the tax system in different parts of the commonwealth.

In the farming towns, in which live stock is most fully and regularly assessed, the result is not unjust as between the individual taxpayers of those localities. It does often bring it about, however, that these towns pay a larger share than is just of state and county taxes, because their total valuation is high, and their assessment for state and county taxes correspondingly large. For these real difficulties we shall propose some remedy. But it is not clear that anything would be gained in these parts of the commonwealth if it were enacted, as is proposed by some organizations, that all local taxation be confined to real estate, and all personal property, including live stock, be exempt from local taxes. The result of such a change in these places would be that, the total tax burden for town purposes remaining the same, some individuals would pay a larger share and some a smaller share than at present. The farmers having much live stock as compared with their real

estate would pay less in proportion to their total property than those having comparatively little. On the whole, therefore, as between the taxpayers of a farming town, the present method of taxing both real estate and tangible personal property probably works better than the method of taxing realty alone would, and brings more nearly just and proportional taxation. Indeed, all authorities are agreed that the general property tax, which was first put into effect in this country under industrial conditions very similar to those which we now find in a farming town, works well under these conditions, but becomes more and more difficult of satisfactory application as property becomes larger in quantity and more complex in character. Hence, in the larger towns of diversified industries, and in the cities, the difficulties in the taxation of these forms of personalty are great, and the actual practice shows much variety as between different places, — all these difficulties and divergencies being part of the general difficulty of applying any general property tax.

As appears from the figures given above, stock in trade forms a very important part of the taxed personal property. Like other personalty, it is taxed chiefly by estimate. Sworn statements, it is true, are sometimes handed in. Where the estimates of the assessors are thought to be excessive, sworn returns are made, in the current year or in the succeeding year, in order to secure reductions. Occasionally it happens that a firm makes a return of a larger amount of stock in trade than it actually has, and is taxed accordingly; while, at a later date, the firm collapses, with assets less than the assessed valuation of its stock. It thus appears that returns of large amounts of property and high tax assessments are sometimes devices to bolster up credit. But these are exceptional cases. As a rule, the assessors make an estimate of stock in trade, and the taxes assessed by this estimate are paid with little demur; such protests as are made taking the form of remonstrance, friendly or otherwise, rather than of sworn returns.

We believe, on the whole, that this method of taxing stock in trade by estimate, with the possibility of correction by formal sworn return and informal conference, works better than would a system of rigidly enforced statements.

To tax stock in trade rigorously, in accord with the letter of the law, would bring about injustice as between different business enterprises. No deduction from the assessed stock in trade is now allowed for debts. Doubtless this is the best course, at all events the only possible course; for to allow such deduction would open the door to fraud and evasion through real, fictitious, or adroitly arranged debts. This, we understand, is the consequence of allowing deduction for debts from all personal property in the state of New York. On the other hand, to tax business men strictly and unerringly according to their precise stock in trade at a given date, irrespective of liabilities, might result in great inequalities. Of two merchants having the same stock, one may have a considerable capital and no debts, while the other may do business largely on borrowed capital and may be subject to a heavy interest charge. Of two businesses of the same size and profit, one may have a rapid turnover and a comparatively small stock at any one time, while the other may have a slow turnover and a larger stock. In these cases, and in the countless others which can readily be imagined, taxation precisely in proportion to stock in trade would be unequal and unsatisfactory.

On the other hand, assessors' estimate, while more or less uncertain, is not without some reasonable basis. The size of the premises, the nature of the trade, general repute as to profits and volume of business, give clews as to the relative taxable abilities of different concerns. Capable and conscientious assessors are thus able to assess taxes, if not perfectly, at least with a reasonable approximation to justice; and so much we believe is generally achieved by the assessors of the commonwealth in this part of the tax system.

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Machinery, like stock in trade, is taxed usually by assessors' estimate. As in the case of stock in trade, something about it can be ascertained by the assessors without difficulty, — its existence, at least, and a rough idea of its value. The exact value of machinery is indeed as difficult to judge as the exact value of merchants' stock. The changes by invention, changes in fashion, in demand for goods made, in the general state of trade,

make it almost impossible to ascertain that fair cash value which the tax law contemplates.

In different cities and towns of the commonwealth there are some important differences in the practice as to the assessment and taxation of machinery. In some places the tendency is to tax lightly; in others, to tax heavily. In a town where manufacturing industries are newly set up, or to which it is desired to attract manufactures, machinery is taxed lightly. In places where manufactures are old and established, the tendency sometimes is to tax too heavily. This is more especially the case where the machinery belongs to a Massachusetts corporation. Here the corporation is certain to be taxed in any case for the full market value of the shares. If it is locally assessed for a small amount on its real estate and machinery, so much more goes by way of tax on corporate excess, or franchise; if it is locally taxed for a large sum, so much less is left for corporate excess. The temptation for the town is to tax the local real estate and machinery heavily, and so gather for itself as large a share as possible of the total tax collected from the corporation. The tax commissioner, however, has authority to supervise the assessments so made as to the local property of corporations, and exercises a check on undue exactions by the towns.

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The most difficult part of the tax system, and that as to which there is most dispute, is the taxation of securities, cash assets, income, and other intangible personal property. Under this head come stocks and bonds of foreign corporations, money at interest, loans on mortgage of property other than real estate taxable in the state, bonds of Massachusetts corporations, and income from trade or profession. All these are by law now taxable. Shares in Massachusetts corporations and in banks, loans on mortgage of real estate taxable in the state, and deposits in Massachusetts savings banks, are not taxable directly to their holders.

Whatever may be the truth as to other parts of the tax system, it is admitted on all sides that this part is unsatisfactory. From every quarter there are demands for change. Some organizations maintain that such property is now taxed too heavily, and should be relieved; others that it is too lightly taxed, and should

be further reached. The distribution of the proceeds of the taxes on such property between the different cities and towns of the commonwealth is, in our opinion, clearly unjustifiable. Moreover, this is a part of the tax system which invites change, because it does not work with such certainty and regularity as to enable the taxpayers to accommodate their affairs to it. Any tax of long standing and of steady and unfailing operation, to which the affairs of taxpayers and of the community have been adjusted, should not be changed without strong cause. On the other hand, any tax which is uncertain and irregular in its operation is not only objectionable in itself, but invites and justifies prompt and radical change.

Here, as elsewhere, the taxes are usually assessed by estimate or doomage. It is not possible to state how many in the limited number of sworn statements refer specially to this kind of property; but the figures already cited as to the amount of intangible personalty assessed by statement and by doomage show conclusively that the latter method is practiced in the overwhelming majority of cases. The amount of intangible personalty assessed by statement in twenty-eight cities was $7,311,778, while the amount assessed by doomage was $53,060,-699. In each of the cities a few persons of unusual conscientiousness make returns. Such persons are accordingly taxed fully, and, as a rule, much more heavily than their less conscientious neighbors. In the city of Boston, and to some extent in other cities, trustees not infrequently make returns, especially if their accounts are on record in the probate courts and so are open to the inspection of the assessors. From the testimony which assessors have given before us, there is grave suspicion that sometimes sworn statements are falsely made, and that perjury is thus committed for the sake of evading or reducing taxation. But, after all, sworn statements, for whatever reasons made, are rare in proportion to the total assessment, and in practice the common method of taxing this sort of property, as of taxing other sorts, is doomage by the assessors.

It is obvious, however, that this method of taxation encounters, as to intangible property, exceptional and indeed almost insuperable difficulties. There are no such external indications of taxable liability as appear in the case of live stock, vessels, stock

in trade or machinery. General repute as to the possession of large means, or a mode of life indicating an ample income, do not necessarily signify anything as to taxable securities. The investments of a person of means may be in real estate within or without the state, or in Massachusetts stocks or mortgages, or in bonds of the United States. An ample income, indicated by general expenditure, may be derived either from such sources already taxed or not taxable, or from trade and profession, or from taxable securities, — these last two being taxable, but taxable at very different rates. The assessors hence must rely on their knowledge and judgment in estimating the taxable property of this form. In a great and complicated society, with a mass of investments ramifying in all directions, the assessors are here confronted with a task which the best of them could not execute satisfactorily. Even the most capable, most experienced, and most conscientious assessors could not have sufficient knowledge and judgment. But only average capacity can be expected; experience is often lacking; and, even for conscientious assessors, the temptations to laxity are in many cases irresistible. Consequently, the taxation of this form of property is in high degree uncertain, irregular, and unsatisfactory. It rests mainly on guesswork; it is blind, and therefore unequal. Here is its greatest evil, though not its only evil. It is haphazard in its practical working, and hence demoralizing alike to taxpayers and to tax officials.

In support of this, our first general conclusion on the taxation of intangible personalty, we will now present some further facts.

In some cities — we may specify certain of the larger cities, as Boston, Cambridge, Worcester — the assessors try to follow the law strictly in making their estimates of intangible personal property. They try to ascertain what are the means of a given individual, and how far he has invested in real estate, in mortgages, in foreign securities, in bonds; and they estimate his taxable property accordingly. They pick up information here and there, from casual conversation, adroit question, perhaps remarks overheard on the street, as to the affairs of persons thought to possess property. They are apt to keep private memoranda of such hints, which they use in making their estimates. They

resort to all lawful means of ascertaining the precise possessions of the taxpayers. Of these means, the most important is in the records of the probate courts. As to estates under probate supervision, the inventories and accounts of executors, administrators, and trustees often give precise or at least available information. In many cities these records are systematically followed, and memoranda are taken of the information there contained. By using one source and another, the assessors endeavor to fulfill their duty under the statutes, — "to ascertain as nearly as possible the particulars of the personal estate . . . and make an estimate thereof at its just value."

The amount of taxable property of all kinds in the city of Boston is so great, and the methods of assessment in consequence are so different from those of other parts of the state, that we think it desirable to make some statement as to the tax-assessing machinery of that city. The city has nine principal assessors and forty-two first assistant assessors. In addition, there are second assistant assessors and clerks; but these, though their duties are important, take little part in the procedure we are now describing. The city is parceled into assessment districts, each of which is in charge of a first assistant assessor. The first assistant assessors, with the aid of second assistants and clerks, make the initial assessments and report them to the principal assessors. The assessments of personal property (of all sorts) are then finally brought before the so-called "dooming board." This board consists of all the principal assessors and the first assistant assessors, — fifty-one in all, — and meets daily for a period of about six weeks, from the middle of June. Here each and every assessment of personalty reported by the first assistant assessors for a sum exceeding $5000 is reviewed. Where the initial assessment is for less than $5000 the estimate of the first assistant assessor is not further considered; but where it exceeds that sum, the dooming board revises it, each name and the assessed personalty being presented and considered in detail. Any member of the board who has information may then state it, and the first assistant assessor in charge may defend his estimate and make further recommendations. Doubtful cases are referred to the nine principal assessors for further consideration and final

decision. The principal assessors may indeed review any of the findings of the dooming board, whether expressly referred to them or not; but in practice they rarely do so, unless such reference is made. In the practical working of this machinery the estimate of the first assistant assessor is clearly of the greatest weight. If he sets a valuation of less than $5000, it is conclusive, unless the principal assessors happen to revise his estimate. If he makes a higher estimate, and so causes the taxpayer's name to come before the dooming board, his opinions necessarily have great weight. The other members of the board may offer information or make suggestions; but, in the routine of long and weary sessions, the business is apt to be disposed of by accepting the recommendations of the official immediately in charge. The dooming sessions are secret; only the members may attend; and, beyond the final assessment of a lump sum for personal property, no record or statement of the proceedings is made public.

Members of this commission have attended meetings of the Boston dooming board, and can bear testimony to the zealous and faithful performance of duty by its members. The assessors endeavor to exercise care and discrimination. This is especially the case with regard to the valuation of stock in trade and other tangible personalty, where there is at least some external indication of taxable possessions, and various means exist for ascertaining the business standing of different taxpayers. As to intangible personalty, they confess that they are often entirely in the dark, and never can be sure whether they are acting with undue severity or with undue leniency.

Whether in Boston or elsewhere, the assessors as a rule have no illusions in regard to the success of their efforts. Some of them, indeed, in testimony before us, have expressed the opinion that they succeed in ascertaining most of the taxable securities and investments, and in assessing them in the manner contemplated by law; but, as a rule, they confess frankly that they fail to do so. As to a few individuals, they have more or less accurate information, from probate records or from accidental disclosure; as to the great majority, they guess. They are aware that, in the sum total, their guesses are very much short of the existing intangible property which is lawfully taxable; but in

each individual case — called upon by the statute, as they are, to make an estimate "according to their best information and belief," and rightly unwilling to do injustice by going beyond their information — they do not see their way to higher assessment. They are impelled by some strong motives, of which we shall speak presently, not to raise their assessments, especially in the case of persons of large means, to such a point that the taxpayer thinks of changing his domicile. Complaints are constantly made to them, by those whom they assess, that the neighbors of the complainants, though perhaps richer, are less heavily taxed. But the complainants do not wish to tell tales, and refuse to give names or details. The assessors do not know who is richer, or whether, even if a man be clearly richer, his investments are taxable. They are in large measures helpless. The result is, as we have said, uncertainty, inequality, dissatisfaction.

We have spoken hitherto of the localities where the assessors do their best to fulfill the difficult and indeed almost impossible task imposed on them by law. In other localities they fairly give it up. In still others they do more, — they try to attract people of means by lax assessments; but this involves an aspect of the working of the tax system which we shall discuss presently in another connection. Even where the assessors are reasonably faithful and diligent, they often abandon the attempt to secure specific information as to individual taxpayers. They tax by general estimate, roughly and not heavily, according to common repute as to means and income. It may be that, by so doing, they secure results no less just, possibly more just, than those secured by more eager and diligent assessors. Where the attempt is made to carry out the letter of the present law in every known case, the inequalities between individuals are greater, the accident of discovery becomes important, and the taxes are more pronouncedly irregular, — too heavy on some, too light on others.

That the great bulk of intangible property taxable by law is not reached, is admitted on all hands. It is proved beyond doubt by the sensitive records of the stock and bond market. Securities of all sorts, taxable in Massachusetts but not taxable in New York and in other states, are publicly bought and sold

every day at the same prices in different markets. If taxed according to law in Massachusetts, at a rate of from one to one and a half per cent of their selling value, they could not possibly command the price in Massachusetts which they command in other states; nor could they be sold side by side with shares in Massachusetts corporations, or with mortgage loans, at such prices as to yield about the same interest on the same investment. As a matter of fact, securities of the same solidity and yielding the same income are sold side by side, with no material difference in quotations, whether they are taxable or not taxable. Taxable securities are bought and sold every day, not on the basis of being taxed in fact, but only on the basis of some incalculable and disregarded possibility of their being reached by taxation.

We have already described the tendency of intangible property to concentrate in certain towns of the commonwealth. This tendency is an important part of the working of the present system, and will now receive our further consideration.

Ineffective as is the taxation of securities, its weight is nevertheless felt, both as an actual burden and as an imminent possibility. The temptation is always strong to lighten it as much as possible. The statutes offer a simple, lawful, and effectual method of accomplishing this. The taxation of such personal property follows the domicile of the owner. By establishing a domicile in a town or city where the tax rate is low, or where the assessments are easy-going, the taxes may be reduced greatly, perhaps brought to insignificant dimensions. The larger a person's means and the less the ties of business or profession, the easier it is to select a domicile at will. The climate and scenery of Massachusetts offer many delightful spots for persons of means and of leisure. The more such persons take up their residences in one of these places, the larger is the amount of personal property there taxable, the lower is the tax rate, the slighter is the need for stringent assessments.

We have already given some facts as to the crowding of intangible property into certain towns. To these may be added some further facts, showing the differences in the tax rate which result. The rate of tax varied in 1896 from a minimum of $4.62 per $1000, to a maximum of $26 per $1000. In certain towns

where there was a large accumulation of securities the tax rate was as follows:

Brookline	$12.40	Manchester	$8.20
Cohasset	9.70	Mattapoisett	7.00
Easton	10.80	Milton	9.00
Falmouth	7.70	Nahant	7.50
Groton	9.00	Stockbridge	11.00
Hopedale	10.00	Swampscott	12.00
Lancaster	10.80	Wellesley	11.00
Lincoln	10.00	Weston	8.70

Most of these towns show a very low rate, and all show a rate much below the average.

As a contrast to these towns may be mentioned:

Abington	$22.60	Leominster	$21.75
Adams	21.00	New Ashford	22.00
Athol	23.50	North Attleboro	24.00
Attleboro	21.00	North Brookfield	22.00
Charlemont	23.00	Saugus	22.00
Florida	22.00	Stoughton	25.50
Gardner	22.00	Wendell	21.00
Granville	26.00	Winchendon	23.00
Hawley	23.00	Wrentham	21.80
Holliston	24.40		

It should be borne in mind, moreover, that the tax rate and the reported amount of assessed intangible property do not tell the whole story. The tax rate may not be low, but the valuation may be, and the actual burden of taxation consequently light. While there may be but a small assessment of personal property in the form of securities, there may yet be a large amount owned by inhabitants of a town and not touched by the assessors.

We have reason to believe that the crowding of personal property into certain towns takes place not merely as the result of the law itself, but of negligent and even culpable administration of the law. It is currently stated that persons of means, before taking their domicile in some towns, come to an understanding with the assessors as to the amount for which they shall be taxed. The law provides that, where a person changes his domicile from one place to another, he shall not be assessed in his new place of residence (in the absence of a sworn state-

ment) for a less amount of personal property than had been assessed in his former place of residence. But this applies only to the first year, — after that the assessors are free; and even in the first year it is not certain that the law is always followed. The truth is that the present system offers great temptations. A rich man, coming into a small town and building a handsome house there, adds in any case so much to its taxable resources. The assessors have everything to gain and nothing to lose by attracting such men as residents. Bargains are doubtless very rare; but, what with ignorance as to the amount of property which is taxable, unfamiliarity with the standards of metropolitan wealth, desire to attract new residents, and the competition of other places, it results that assessments for personal property sometimes are not made at all, and very commonly are made at figures much less than moderate.

This situation again has its effect on the assessors in the cities and in other places where the tax rate is high, and where some attempt is made in general to tax according to the letter of the law. A heavy assessment may be met by a change of residence to another town. The larger number of attractive places within easy reach of the cities, and especially of Boston, makes such a change a comparatively simple matter. Where the assessors, rightly or wrongly, push a taxpayer hard, he can give notice that he proposes to take up his domicile elsewhere; and the assessors are helpless. His object may not be to evade his just share of the public burden. It may be simply to avoid such a full disclosure of his affairs as results from the detailed sworn statement which alone the assessors may accept; it may be that he believes — and in good part is justified in believing, as we shall presently explain — that taxation as now prescribed by law works injustice. In any case, the larger a man's means, the easier it is to make a change of residence. Persons of small means, or those tied to any place by business or profession, cannot bring such pressure on the assessors. Hence here again we have a cause of embarrassment for the tax officials, of inequality in assessments, of irritation among the citizens.

* * * * * * *

The taxation of personal property in the form of securities and investments is thus a failure. It is incomplete, uncertain,

not proportional to means as between individuals, grossly unequal in its effects on different parts of the state. The experience of Massachusetts in this regard is the same as that of the other states of the Union. Everywhere, without exception, the testimony is that this part of the system of the general property tax is unequal, unsuccessful, often demoralizing to tax officials, always irritating to taxpayers.

The experience of Massachusetts is the more striking, because here the difficulty does not lie mainly in the administration of the tax laws. The assessors are usually honest, competent, zealous. We have heard much of grave abuses, of almost corrupt laxity, in other states. But in this commonwealth, notwithstanding occasional defections (some of which we have just referred to), the standard of public duty continues to be high, and the cause of failure is not to be found mainly in official dereliction. It lies in the system itself.

42. The General Property Tax in North Carolina. — New York, Massachusetts, and, to a less extent, Maryland are states in which industrial and commercial development is more advanced than it is in many of the states of the South and West. Recent studies of taxation in some of the less advanced states have shown that care should be exercised in applying to purely agricultural communities conclusions drawn from the experience of communities with more diversified economic conditions. As Professor Hollander, the editor of the work in question, has remarked:[1] "It is upon the fiscal conditions of the more advanced commonwealths, where abuses are greatest, both in kind and in degree, that the attention of writers upon American public finance has hitherto been centered. The more careful investigators have been explicit in stating that whatever conclusions might be reached were applicable only to similarly circumstanced societies. But the caution has not always been respected, and the science of finance, like the science of eco-

[1] Studies in State Taxation, edited by J. H. Hollander. Johns Hopkins University Studies in Historical and Political Science, Series XVIII (Baltimore, 1900).

nomics, is exposed to the danger of mischief-making, as the result of rule-of-thumb application of qualified theory. Detailed acquaintance with the fiscal experience of a group of less highly developed states, where corporate organization is limited and intangible wealth a minor element, cannot fail to prove serviceable in this connection."

From the studies edited by Professor Hollander, the account which Professor G. E. Barnett gives of the working of the property tax in North Carolina is reproduced here:[1]

Contrary to the tendency in many states, taxation of property has been of increasing importance in the financial system of North Carolina, from its inception to the present time. Up to 1850, the poll tax rivaled it in productiveness; but when, in that year, what had been a real property tax became practically a general property tax, its return to the state treasury soon outstripped the yield of the poll tax. Since the war, the poll tax has not been paid to the state treasury, and the general property tax has been the mainstay of North Carolina's fiscal system. The increasing importance of this tax is shown by the rise in its rate from time to time. From 1819 to 1855 the rate on property remained stationary at six cents on the hundred dollars. In 1855 this was raised to twelve cents, and in 1856 to fifteen cents. An increase in the kinds of taxable property has accompanied the increase of rate.

The present rate is forty-three cents, apportioned to various funds as follows:

General state purposes	$21\frac{2}{3}$ cents
Pensions	$3\frac{1}{3}$ "
Public schools[2]	18 "

The present constitution of North Carolina provides that "Laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, joint-stock companies or otherwise, and also in all real and personal property according to its

[1] With the consent of the editor, author, and publisher.

[2] As has been said above, the tax for public schools, while levied by the General Assembly, is a county tax in collection and distribution.

true value in money." Prior to the adoption of the present constitution in 1868, there had been no constitutional principles governing the property tax. The amendments of 1835 had enunciated certain rules with regard to the capitation tax, but had left the General Assembly free to levy other taxes as it might see fit. The clause of the present constitution providing for the exemption of certain forms of property is as follows:

"Property belonging to the state, or municipal corporations, shall be exempt from taxation. The General Assembly may exempt cemeteries and property held for educational, scientific, literary, charitable, or religious purposes; also, wearing apparel, arms for muster, household and kitchen furniture, the mechanical and agricultural implements of mechanics and farmers; libraries and scientific instruments, or any other personal property, to a value not exceeding $300."

Over two thirds of the total amount raised by taxation for state purposes in North Carolina is from the general property tax. More than one half of the school revenue and the larger part of county and municipal revenue is from the same source.

Assessment and Collection. — The system of assessment used in North Carolina is that popularly known as the "listing system." Every fourth year, the board of commissioners of each county appoints "three discreet freeholders" in each township who "ascertain the true value in money of every tract or parcel of land or other real estate with the improvements thereon and personal property." This board of three assessors is empowered to administer oaths. The assessment thus made continues in force for four years unless structures of the value of $100 are erected or destroyed on the lands thus assessed. In such case, the assessment is to be changed. The assessors must advertise at five places in the township and must attend at two or more places for the purpose of receiving lists and assessing property. The property owner must appear before them and list his property, which they shall value. The assessment made by this board must be returned to the county commissioners, who with the chairmen of the township boards form a "board of equalization," with power to raise or lower any valuation put on any piece of real or personal property by the township board.

In years other than assessment years, the county commis-

sioners appoint one list-taker for each township. All lands in the township are listed by him at the valuation previously assessed on the same by the board of assessors. Personalty, however, is listed anew each year, and its valuation may be changed.

Each property owner must appear before the list takers and assessors and file a list of his property. This list includes the following items:

1. Quantity of land owned in township.

2. Horses, mules, jacks, jennies, goats, cattle, hogs, and sheep, separately, with the true value thereof.

3. Farming utensils, tools of mechanics, furniture, firearms, provisions, libraries, and scientific instruments, separately, with the value thereof.

4. Money on hand, including all funds invested within thirty days before in United States bonds or other non-taxable property.

5. The amount of credits, including interest, whether in or out of the state. Bank deposits and property in the hands of commission merchants are deemed credits. If any credit be not regarded as entirely solvent, it is given in at the market or current rate. The party may deduct from the amount of credits owing to him the amount of collectible debts owed by him as principal debtor.

6. Building and loan association stock.

7. Money investments, stocks and bonds of whatever nature except bonds of the United States and of North Carolina, and such other bonds as may have been expressly exempted from taxation by law in this state.

8. All other personal property whatever.

9. The gross income of the party the twelve months preceding, not derived from property already taxed, and also income beyond $1000 derived from salaries or fees or both.

The law further provides that the taxpayer must swear that the list handed in by him contains all the property which he is required to list and that the value fixed thereon is a true valuation. It is a misdemeanor punishable with fine or imprisonment or both for a taxable person to refuse to list, or to refuse to answer any questions respecting his property. The board of

county commissioners of each county reviews the tax lists returned, and has power to raise or lower valuations. If any property escapes taxation and such escape is afterward discovered, back taxes for five years may be collected, and in the case of lands 25 per cent extra tax may be added. Any person failing to list poll or property is charged twice the amount of what would otherwise be exacted.

The sheriff is the officer of collection; he is required to enforce collection by the sale of personal property if sufficient, and if not, by selling the real estate of the delinquent. A new instrument for the collection of taxes was introduced by the General Assembly of 1897, *viz.*, imprisonment. The law, proving impracticable, was repealed in 1899.

Defects of the Property Tax. — The system of assessment outlined above is free from some of the conspicuous defects of the general property tax in other states. The assessors are appointed by the county commissioners and are not elected by the people. Hence, they do not have that inducement to curry popular favor by undervaluation, which has become in many places one of the gravest evils of the general property tax. Then, again, the assessment for county purposes being based upon the same list as the state assessment, there is lacking the temptation to undervalue property in order to lighten the state tax on the county in proportion to that in the rest of the state. "Boards of Equalization," in the Western sense, are not needed. The valuation of all railroad property in the state has been placed, as described below, in the hands of a single commission, and irregular assessment has thus been prevented.

Many defects do, however, appear in the listing of property. In his report for 1897, the auditor states that only one county in the state had returned a uniform number of acres of land for taxation during the previous five years. Slight variations in the numbers of acres of land returned are, however, of little importance as compared with the great question of the proper return of personalty. There can be no doubt that in North Carolina, as in most other states in the Union, an enormous amount of personal property escapes taxation. It happens in two ways: (1) visible personal property, such as furniture, cows, etc., is grossly undervalued; (2) much invisible personal property is not

listed. The first happens to some extent with respect to all kinds of property, but more largely with personalty, since the value of a particular horse is not usually known to the assessor, and the animal is less valuable to many owners just at listing time. The second manner of escape is peculiar to personal property. Stocks, bonds, and credits are difficult to reach, and the memory of the owner is apt to prove treacherous. The following table will show how the amount of stock varied in certain counties:

	1893	1894	1895	1896	1897
County	Stock, etc.	Stock, etc.	Stock, etc.	Stock, etc.	Stock, etc.
Cabarrus	$99,000	$103,000	$81,000	$31,000	$20,811
Guildford . . .	93,000	42,000	9,000	78,000	13,725
Forsyth	50,000	140,000	32,000	18,000	267,579
Rowen	444,000	42,000	16,000	299,000	12,685
Durham	265,000	104,000	1,028,000	1,344,000	1,410,000
New Hanover . .	195,425	37,937	114,508	67,650	10,200
Catawba	30,779	40,804	21,817	2,296	4,709

One part of the North Carolina listing act appears to have been especially intended to aid the "tax-dodger" in accomplishing his designs. Paragraph 7, section 16, of the assessment act declares: "The party may deduct from the amount of his credits owing to him the amount of collectible debts owing by him as principal creditor." This provision may be attacked from two sides. In the first place, why should a taxpayer be allowed to deduct his debts from his solvent credits more than from any other item? He can only reduce his taxes on account of his debts, if his property happens — in part at least — to take the form of solvent credits. This is an injustice to other taxpayers. If allowance is to be made for debt, it should be made in all cases. In the second place, such an exemption furnishes a cover for evasion of taxation. If a taxpayer owns a mortgage, he may set off against this credit his real or fictitious debts. If this privilege were not allowed him, he would be obliged to list his mortgage, since it is a matter of public record, and he would

not dare to neglect to give it in to the assessor or list taker. But as it is, who can say what a man owes? Even though the assessor knows of many solvent credits belonging to such taxpayer, he can have no means of ascertaining the offsetting indebtedness, since the taxpayer is not required to enumerate or state his debts. He simply makes a sworn statement that his solvent credits exceed his debts by a certain amount.

Undoubtedly, the property tax in North Carolina is more nearly a measure of ability than in many American commonwealths. In a state so largely rural, where much is known of neighbors' affairs, tax-dodging must of necessity be less than in states with more and larger cities, where the public inspection of tax books is neither common nor practicable.[1]

[1] Elsewhere Professor Barnett remarks: "The basis of state taxation in North Carolina must remain for some time to come the general property tax. Constitutional provisions and economic conditions both lead to that conclusion. The practicable reform of the tax system of the state is along two lines: (1) the better assessment and collection of the general property tax itself; (2) the adoption and extension of such taxes as will counterbalance the lack of progressivity characterizing the general property tax.

"The chief fault of the general property tax in North Carolina is, as has already been shown, the allowance of an exemption of debts to the taxpayer. With this removed, there is every reason to believe that a more honest return of solvent credits would be made than under the present system, wherein the law favors fraud by rendering it impossible of detection."

CHAPTER XII

THE GENERAL INCOME TAX

43. The Prussian Income Tax. — This tax has had an interesting history, since it has developed out of graduated capitation or class taxes which date back to 1821. In that year, in order to meet a deficit, the Prussian government established a class tax. This law grouped the population in four classes, according to social position; and then imposed three different rates of taxation within each class in order to allow for differences of wealth between the members of the same social class. The result was a graduated capitation or class tax with twelve different rates. The new tax was believed to be "a happy compromise" between a uniform poll tax and an income tax which would have required "minute and vexatious inquiry into the financial condition of the taxpayer." It did not, however, apply to cities; since in such places there already existed a grist and slaughter tax[1] which was considered a satisfactory substitute. The class tax did not prove successful in reaching the larger incomes, and it was found that, in 1846, 45 per cent of its yield came from the lowest class and only $3\frac{1}{2}$ per cent from the highest. Accordingly in 1851 it was supplemented by an income tax which, as amended at various times — notably in 1891, is now one of the chief branches of Prussian revenue. Dr. Joseph A. Hill gives the following account of the development of the income tax in Prussia since the reform of the class tax in 1851:[2]

[1] The grist and slaughter tax had been tried in country districts, but had not proved satisfactory because it was difficult to enforce.

[2] Reprinted, with the consent of the author, from the *Quarterly Journal of Economics*, VI, 212–225.

The successful reform bill, which became law in 1851, was of a still milder character.[1] The grist and slaughter tax for the large cities was retained. The class tax, confined as before to the smaller cities and country districts, was curtailed by the abolition of the highest class. For the three remaining classes, which were to include all taxpayers having incomes of not more than 1000 thalers, thirteen rates were prescribed, of which the highest was 24 thalers annually, while the lowest was, as before, $\frac{1}{2}$ thaler. To replace the tax on the highest class, a classified income tax was adopted, to be assessed throughout the entire kingdom on all incomes of more than 1000 thalers, with a rebate of 20 thalers in those cities which were subject to the grist and slaughter tax. The payers of this income tax were divided into thirty classes. In the lowest the annual rate was 30 thalers, in the highest 7200 thalers. These rates were graded with the intention of collecting 3 per cent of the minimum income in each class. This made the minimum for the highest class 240,000 thalers; and the amount by which any income exceeded that limit was, therefore, not taxed. No declaration was required from the taxpayer, and the assessment was to be made without "inquisitorial procedure."

In the two previous attempts at reform the main end in view had been a more equitable distribution of the burden of taxation. There had been no expectation of any considerable increase of revenue. But, in framing the law of 1851, the need of more revenue had been the principal consideration. Any sort of income tax which would meet this need was regarded as better than none. It cannot be denied, therefore, that "the Prussian income tax was introduced, not solely from a recognition of its social necessity, but at the same time on account of pressing financial needs." It is not strange, then, that the law did not fulfill the requirements of an equitable income tax. Its most serious defect was the retention of a maximum limit to the rates. Besides this the classification was not fine enough; that is, the dividing limits between the classes were too far apart. The result was a rather wide variation in the rate per cent of the tax; for while, as we have seen, it was 3 per cent

[1] Milder, that is, than a measure proposed in 1847, which the author had previously described. — Ed.

of the minimum income in each class, on the maximum income it was in most cases equivalent to only about $2\frac{1}{2}$ per cent. On the whole, it may be said that this reform, like the introduction of the class tax in 1820, aimed principally at an increase in the public revenue, and obtained it by taxing the poor not less and the rich considerably more.

The conditions under which the next reform was accomplished, in 1873, were more favorable, since at that time any increase of taxes was not necessary. On the contrary, the state of the public finances was such — thanks to the French milliards — that the people felt justified in demanding some relief from taxation, and it was partly in response to this demand that the reform was undertaken. The grist and slaughter tax was repealed, to be replaced in those cities where it had existed by the class tax. The latter was now recognized as being, in fact, an income tax which was to be assessed "on the basis of the estimated value of the annual income." This was only a recognition of what had long been the case in actual practice. Indeed, the instructions for the assessment of the tax issued by the finance minister in 1867 had designated numerically certain incomes which were to be treated as *Anhaltspuncte* in assessing the several rates, and stated furthermore that the "presumable income" of the taxpayer was to be regarded as "not indeed the sole determining factor in the assessment, but still the principal one." Other circumstances were also to be considered, whereas the income tax was assessed "*solely* on the basis of income." This distinction between the two taxes was, on the whole, still maintained in the law of 1873, except as regards the two lowest classes of the income tax.

The maximum income subject to the class tax remained, as before, 1000 thalers, or 3000 marks; but now for the first time the law also prescribed a minimum taxable income. The limit selected was 420 marks, all incomes below that being thus exempted from direct taxation. The intention apparently was to exempt all who had previously been assessed with the lowest tax ($\frac{1}{2}$ thaler), which now disappeared from the scale of rates.[1] This, we may say, was the final disappearance of the one half

[1] In 1873, out of 9,300,000 persons assessed under the class and income tax, 5,000,000 paid the one half thaler rate. The number actually exempted when the new

thaler poll tax of 1811. But, while the reform may have been prompted to some extent by the desire to relieve the poorer classes from the burden of taxation, apparently the difficulty and expense of collecting the tax from such classes, especially in the larger cities, where the class tax was now to be introduced, had the most to do with this new departure. But, in making the tax unprogressive, — or better, perhaps, degressive, — there was undeniably the intention of favoring the poor. There were twelve rates, ranging from 3 marks to 72 marks; and the equivalent rates per cent on the minimum income of each class increased gradually from $\frac{5}{7}$ per cent in the lowest class to $2\frac{2}{3}$ in the highest. The tax on the incomes at the lower end of the scale was reduced, while at the upper end it remained about as it was before.

In the income tax the rates were, as before, equivalent to 3 per cent of the minimum income of each class. But the number of classes was increased, and, more important still, the maximum limit to the tax was removed. Incomes up to 780,000 marks were rated in forty classes, and beyond that point the tax increased 1800 marks for every 60,000 marks' increase of income. The same line of reform was carried a step farther in the years 1880 to 1883. An increase of revenue, derived principally from the imperial tariff and tobacco tax, — the proceeds of which, in excess of 130,000,000 marks, are divided among the states in the form of the so-called *Ueberweisungen*, — made a reduction of direct taxation possible, which, it was felt, should accrue to the benefit of the poorer classes. With this end in view, the two lowest rates of the class tax were abolished, thus exempting all incomes up to 900 marks, and the other rates were reduced, as well as the two lowest rates of the income tax, so that the principle of degressive taxation now applied to all incomes under 4200 marks.

Such had been the development of the class and income tax down to the reforms of the present year. The law of June 24, 1891, like that of 1873, has been enacted under favorable financial conditions, which relieved the government from the necessity of asking for any increase of taxes; and, while the

law went into operation, in 1874, was 6,400,000. See Zeitschrift des preussischen statistischen Bureaus, Bd. 15 (1875), p. 112.

reform can hardly fail to make the tax more productive, a guarantee has been given that any such result shall not accrue to the benefit of the public treasury, but lead to a relief from some other form of taxation or else to a reduction in the rates of the income tax itself. This time it was the net earnings from the state railroads, which, as Cohn says, made it possible to indulge in the luxury of distinguishing between a reform of the public finance and an increase of public revenue, — an indulgence which he seems to regard as very improvident, if not enervating.

But, if fiscal motives be wholly wanting in the new law,— which, after all, there is some reason to doubt, — it only adds to the interest and significance of the reform, since, if the burden of taxation is to remain the same, but be more justly distributed, we may draw some inferences as to what ideals of just taxation find favor in Prussia at the present time, even if we must premise that, as is usual in tax reforms, considerations of practical expediency have had quite as much weight as notions of abstract justice.

The new law introduces important changes in the method of assessment, the classification, and the rates. The class tax is no longer retained, and the incomes on which it was formerly assessed are now properly included under the income tax; but there is still a distinction as regards the method of assessment, since these incomes are, as before, to be estimated without, as a rule, requiring any declaration from the taxpayer, while for incomes above 3000 marks a declaration is required. This important reform, which has repeatedly been rejected by the Landtag, now encountered but little opposition,[1] and is a significant departure from the principles on which the assessment has heretofore been conducted. The law of 1851 was very explicit in the assurance it gave the taxpayer that there should be no intrusion into his private business affairs. To be sure, the chairman of the board of assessors was to collect the fullest pos-

[1] The declaration had been a feature of the unsuccessful income and property tax of 1812. It was strongly advocated by Stein and other leading statesmen of that period, but was rejected when the class tax of 1820 was adopted. It was rejected again in 1847, 1851, and 1869. In 1873 the government, although recognizing it as a desirable method of assessment, did not venture to propose it, feeling certain that the Landtag would not adopt it. See Annalen des deutschen Reichs, 1874, p. 939.

sible information in regard to the financial condition of the taxpayers, but only in so far as it could be done without a too-searching inquiry, — *ohne tieferes Eindringen*. The other members of the board were to subject the chairman's results to a careful examination, in which they were to make use of all sources of information at their command. But here again all intrusive inquiry — *jedes lästige Eindringen* — was to be avoided. Even when an appeal was made against the assessment, the proper tribunal must endeavor to get at the truth by the less rigorous method above described, before it exercised the right to institute a more thorough investigation and require definite statements from the appellant, summon witnesses, and so on. These provisions were not repealed or altered in 1873. The results of this method of assessment have proved very unsatisfactory. Outside of fixed salaries very few incomes have been assessed at their full value; and, as might be expected, the wealthier taxpayers were generally the ones who profited most by this leniency. Of course, from the nature of the case, any estimate of the extent of this undervaluation must be inaccurate. Yet it seems to be the general opinion in Prussia that, on the average, incomes have been rated at less than one half or even less than one third their true value; and this means that in individual cases the undervaluation has been far greater.[1]

Hereafter the Prussian taxpayer must make out a written return of his income, if it exceeds 3000 marks, entering it under the following four heads: 1. Income from invested capital; *i.e.*, interest and dividends. 2. Income from real estate, — *aus Grundvermögen*, — whether derived from its use or its ownership or both. 3. Profits or the earnings from trades, industries, and mines. 4. Wages, salaries, professional earnings, or pensions, annuities, or other sources of periodical income not included under the first three heads. It is only necessary to give the lump sum under each head without any further specifications. No oath is required, but simply an affirmation of the truth of the statement. These returns are subjected to the supervision of a county (*Kreis*) board of assessors, the majority

[1] See Annalen des deutschen Reichs, 1874, pp. 929 and 339; also Cohn, Die preussische Steuerreform, in Jahrbücher für Nationalökonomie (1891), Bd. 56, p. 31; and Delbrück, as quoted below.

of whom are elected in the county or assessment district, while the minority, including the chairman, are appointed by the government. If the taxpayer refuses to declare his income, he loses, in the first instance, the legal right of complaint or appeal against the official assessment; and, in case of a second refusal, the assessment is increased 25 per cent. False declarations, willfully made, are punishable with heavy fines. In this way, it is expected to obtain approximately correct returns. Whether this expectation will be realized remains to be seen; but there are good reasons to believe it will not, especially as this change is accompanied, as we shall see, by an increase in the rates on large incomes. In this connection, I may quote the opinion of Professor Delbrück of Berlin, expressed in the way of comment on a notorious case, which came up in the courts recently, where it was proved that a group of wealthy taxpayers had been assessed altogether too low:

> The Bochum tax case is seasoning for the new income tax law. The rich men in that place have almost all been assessed too low by half and two thirds, and to such a scandal as that, it is said, the declaration ought to and will put an end hereafter. "Ought to." Yes, but "will" as well? In the first place, I dare make the assertion that in the entire monarchy the case is the same as in Bochum. Select at random any city or county, subject it to the same test, and you will reach the same results. Without doubt the declaration will secure better returns than the previous method of assessment. For once we will venture to prophesy, and say that (apart from the new tax on corporations and the higher rates) it will secure an increase of from 25 to 30 per cent. Had it not been for the Bochum case, we would have said 25 per cent; but the alarm which this affair has occasioned may well help us to 30 per cent. But by how much was the assessment too low in the Bochum case? By one half to two thirds, and even more. This amount will not come to light even under the new system. . . . So long as we have not reached an inheritance tax and a considerable reduction in the communal sur-taxes, the declaration will be of little benefit. The strictest control and a reasonable moderation in the rates, — without these two wheels it is impossible to set the wagon going. (*Preussische Jahrbücher*, July, 1891.)

The assessment of incomes, then, in Prussia, has not been so very much better than that of personal property in America; nor is it certain that the new law is going to solve the problem for the former country. Yet in Prussia there is an efficient and reliable civil service; and the private citizen, moreover, is accustomed to submit to a good deal of investigation of his affairs on

the part of the public authorities. All this renders the success of such a law more probable there than in America, where, indeed, the attempts already made in certain states to secure correct returns of personal property by means of declarations have proved wholly ineffectual.

In grading the incomes, the new law has made the divisions much finer than before. There are now 75 grades or classes for incomes from 3000 up to 120,000 marks, while under the law of 1873 there were only 27, and before that 19. Beyond this point the increment of increase in the new classification is 5000 marks, while in the old it was for a few grades 24,000 marks, and finally mounted to 60,000. As a result of this change, it is now necessary to ascertain the taxpayer's income with an approach to accuracy which was not required before, and would at any rate be impossible without the declarations. Under the former classification the assessors, even though they were required to avoid *jedes lästige Eindringen*, might perhaps decide with some confidence that a man's income was, for instance, somewhere between 60,000 and 72,000 marks. Any variation within these limits could be neglected, since it did not affect the rate. Under the new law, however, there are now seven classes within the same limits; and it is necessary to decide whether, in the given case, the income is between 60,000 and 62,000 marks, or between 62,000 and 64,000, and so on, thus implying a pretty exact knowledge of the financial situation of the taxpayer, such as could hardly be obtained without his coöperation. Moreover, when once the income is ascertained, the new classification will have the effect of increasing the tax in most cases, for the reason that, under a classified income tax, the amount by which any income exceeds the minimum limit of the class in which it is rated is practically untaxed. The narrower the classes, therefore, the smaller these portions of untaxed income must be.

Of especial importance are the changes which the law has made in the rates. Beginning with the lowest class, which includes incomes from 900 to 1050 marks, the tax is 6 marks, being equivalent to about .62 of 1 per cent of the mean income. This rate increases until it reaches 3 per cent on an income of 10,000 marks, which, it will be remembered, was the uniform

rate per cent of the former income tax. In the ministerial bill the progression ceased at this point; and thereafter the rate was uniformly 3 per cent of the mean income in each class. But the Lower House of the Landtag was not content with this. Unlike its predecessor of 1847–51, it was more radical than the government, and in the bill as finally passed the 3 per cent rate is retained only on incomes between 10,000 and 30,000 marks. Then the progression begins again, and continues until the rate reaches 4 per cent on an income of 100,000 marks. Thereafter this remains the uniform rate per cent estimated on the minimum income of each class; or, in other words, the tax increases 200 marks for every 5000 marks' increase of income.[1] Speaking generally, then, the effect of the new law is to lower the tax on incomes under 10,000 marks and increase it on higher incomes. And even for incomes between 10,000 and 30,000 marks, where the rate is nominally, as before, 3 per cent, there is really an increase of taxation resulting: first, from the increase in the number of classes; and, secondly, from the fact that the tax is now 3 per cent of the *mean* instead of the *minimum* income in each class. To illustrate: under the old law an income between 14,400 and 16,800 marks was rated in class 12 and assessed 432 marks; under the new law this income would be taxed as follows:

Class	Income	Tax (= 3 per cent of the mean income)
30	13,500–14,500	420
31	14,500–15,500	450
32	15,500–16,500	480
33	16,500–17,500	510

There is here, then, a slight reduction in the tax on incomes between 14,400 and 14,500 marks, but above that point the tax is more than it was under the old classification.

In the assessment of small incomes, the Prussian law has

[1] It must not be forgotten that these rates by no means give the full amount of the income tax. The communal sur-taxes must be added to the state tax, and often have the effect of more than doubling the rates given above.

always favored the taxpayer by granting a partial or complete abatement of his tax, if he had to support a large family, or contend with any special misfortunes or disadvantages such as serious cases of sickness, accident, fire, floods, or debt. This was a feature of the class tax of 1851. The law of 1873 retained this feature, and introduced it for the two lowest grades of the income tax as well, so that all taxpayers whose incomes did not exceed 4200 marks were entitled to this special consideration, although under the income tax the reduction could not be carried farther than to the next lower rate. The law of 1891 gives a still wider application of this principle, by permitting a reduction of the tax to an extent not exceeding three grades on account of "any special economic conditions which seriously impair the efficiency (*Leistungsfähigkeit*)" of the taxpayer whose taxable income does not exceed 9500 marks. The exact nature of the special economic conditions is not more definitely described, but presumably the intention is to include such cases as were expressly mentioned in previous laws. The case of children in the family, however, is especially provided for; and, while the reduction is confined to the incomes under 3000 marks, — a return in this case to the limit of 1851, — it is not as before simply permitted, but is required and definitely regulated by law, since for every dependent member of the family under fourteen years of age 50 marks must be deducted from the taxable income of the head of the family. This of itself would not in every case produce a reduction of the tax; but the law further provides that, if there are three or more such members in the family, the tax itself must, at all events, be reduced by at least one grade.

One other new feature in this law is the taxation of corporations and stock companies, which must now pay the income tax on all dividends and net earnings above $3\frac{1}{2}$ per cent of the capital paid in. The dividends are of course also included in the income of the stockholder, and, if he is a Prussian, are taxed as such. This results in the double taxation of the excess above $3\frac{1}{2}$ per cent; but in this way and to this extent the foreign stockholder is taxed once, which seems to have been regarded as a strong argument in support of this provision. The double taxation of the Prussian stockholder may, perhaps, be defended

on the principle of the higher taxation of funded incomes, which, as we have seen, was a feature of the unsuccessful tax bill of 1847; but the provision appears to be simply a compromise between the desire to tax the foreign stockholder and the opposition which might be made against taxing the Prussian stockholder twice on the full amount of his dividends.

Thus the development of personal taxation in Prussia has resulted in the adoption of a partially progressive income tax. The general tendency of each reform may be more clearly seen, perhaps, if we indicate briefly the steps by which this result has been reached.

1. A uniform poll tax, 1811.

2. A class tax, collecting somewhat more from the prosperous and not less from the poor, 1820–21.

3. To supplement the class tax, an income tax with comparatively few classes, a uniform rate, and a maximum limit, 1851.

4. Classification made finer, the maximum limit removed, and the class tax made practically an income tax, with a progressive rate, and the exemption of incomes up to 420 marks, 1873.

5. Exemption of incomes up to 900 marks, reduction of the remaining rates of the class tax and of the two lowest rates of the income tax, 1881–83.

6. The principle of progression extended to all incomes under 100,000 marks, incomes under 10,000 marks taxed less than before, and higher incomes more; a declaration of income by the taxpayer required, and a finer classification adopted, 1891.

In connection with this *résumé* it may be well to note that such progression as existed in the rates on small incomes previous to this latest reform was probably not a true recognition of the progressive principle of taxation, but simply a reduction of the regular rate made in view of the fact that the indirect taxes collect proportionally more from the smaller incomes than from the larger, so that, when we consider the tax system as a whole, the aim was not progressive, but simply proportional taxation. Such a reduction from the normal or uniform rate German writers designate as degressive taxation. In the new law, however, the progressive principle finds a distinct although partial application, since in collecting 4 per cent from incomes of

100,000 marks or more and only 3 per cent or less from incomes under 30,000 marks, it is manifestly the intention that the rich shall contribute, not simply more proportionally than the poor, but also more than men of moderate means. Strictly considered, then, this is not an extension of the progressive principle, but its introduction.[1]

44. The British Income Tax. — Dr. Hill describes the working of this tax as follows:[2]

I. General Description

The tax has had, in fact, a somewhat remarkable history. Originally adopted as a temporary resource, it has now been assessed for over fifty years without any interruption; and although still, in form, a temporary tax, requiring for its continuance an annual renewal by act of Parliament, it is, in all probability, as firmly established and as permanent as any part of the revenue system. The tax is, however, more than fifty years old if we date its age from its first appearance in the fiscal system of England. A tax on incomes was resorted to by William Pitt as far back as 1798, and the income tax in its present form was introduced in 1803. These were war taxes. At that period a direct tax on income could hardly have been levied by any government in a time of peace. But under the pressure of the heavy strain which the struggle with Napoleon was imposing upon the financial resources of England, it was accepted as a burdensome but justifiable demand upon the patriotism of the nation. When the Napoleonic wars terminated with the Battle of Waterloo and a permanent peace had been established under the Treaty of Vienna, the tax was at once discontinued. It was not resorted to again until 1842. In that year Sir Robert Peel revived it, partly to provide for a deficit in the budget and partly to enable him to make certain

[1] It may be noted that in the communal sur-taxes the progression has often been carried much farther and made much sharper than in the state tax. See Neumann, Einkommensteuer, pp. 112 *et seq.*

[2] Reprinted from The English Income Tax, by Dr. J. A. Hill, in Economic Studies of the American Economic Association, 1899. Reprinted with the consent of the author and the Association.

reductions and reforms in the complicated system of protective import duties. It was expected that this revival would be only temporary, but it proved to be permanent. The government has never since found itself quite ready to part with this source of revenue, and the country, as represented by Parliament, has never insisted on being relieved from the impost; and so the income tax has been continued to the present day. It was many years, however, before the intention of ultimately dispensing with it was virtually abandoned. In 1853 Mr. Gladstone came before Parliament with a comprehensive and far-reaching financial programme which he confidently believed would place the government in a position to part with the income tax at the expiration of seven years; and it is probable that this expectation would have been realized and that the tax could and perhaps would have been given up at the end of that period, had it not been for the Crimean War. That unexpected event involved large expenditures which Mr. Gladstone had not anticipated, and when the year 1860 arrived he had no alternative but to ask for a renewal of the tax. Again, in 1874, when Mr. Gladstone felt constrained to dissolve Parliament and appeal to the country, he offered, in event of his return to office, to abolish the income tax. Mr. Gladstone's party, however, was defeated. But the election did not turn upon financial questions and could hardly be regarded as a popular verdict in favor of the income tax. Still the Disraeli ministry, which now came into office, naturally felt free to continue the tax and found it desirable to do so; and since that time no prime minister has ever proposed to part with this convenient and productive source of revenue.

In the earlier period of its history the tax was several times granted for a term of years. But ever since 1860 it has been an annual impost, which would expire with the close of the fiscal year if it should not be renewed by Parliament. This annual renewal affords an opportunity to adjust the rate of the tax to the condition of the finances. If, for instance, the revenues are insufficient, the necessities of the government may be provided for by adding another penny to the rate. If there is an excess of revenue, the country can be relieved from unnecessary taxation and the accumulation of idle funds in the treasury forestalled by taking off a penny. In this way the tax has re-

peatedly proved to be a highly convenient resource, of which the chancellor of the exchequer has availed himself both when he was confronted with the prospect of a deficit and when he was in the more fortunate position of having a surplus at his disposal. Hence in the English budget the income tax has served as a sort of regulator or adjustable element by means of which a close correspondence between revenue and expenditure can readily be maintained. This explains why the rate has undergone such frequent changes. For a number of years after 1842 the tax was kept at *7d.* in the pound, or a little less than 3 per cent. During the Crimean War it was increased to *16d.*; and since that period changes have been made every year or two. The lowest point was reached in 1875, the rate then being only *2d.* in the pound. Since 1880 it has varied from *5d.* to *8a.*[1]

From time to time changes have likewise been made in the exemptions and abatements which are granted to the possessors of small incomes. In recent years the range of these abatements has been very much extended, and in effect the tax has thereby been made progressive as regards incomes between £160 and £700. Incomes under £160 are wholly exempt, and incomes above £700 bear the full rate of the tax without any relief or abatement.[2]

In other respects the tax has undergone hardly any changes of importance since it was first introduced. In its main features it is the same to-day that it was ninety years ago; and even in details the changes have been comparatively few. The assessment is still for the most part regulated by the Act of 1842, and that Act is in turn a close reproduction, in form as well as substance, of the Act of 1807.

That the English income tax should have been in this way retained and perpetuated until it has become apparently a

[1] In order to meet the demands of the war in South Africa, the rate of the income tax was advanced to *1s.* in 1900, and then to *1s. 2d.* in 1901, and *1s. 3d.* in 1902. Under a rate of *8d.* the yield of the tax was £18,800,000 in 1899–1900. With the increased rates, its yield advanced to £29,700,000 in 1900–01; to £35,400,000 in 1901–02; and to £38,700,000 in 1902–03. — ED.

[2] As Dr. Hill explains in a later chapter, which we cannot reproduce, the law now exempts all incomes of £160 or less. Then it grants abatements on incomes between £160 and £700, the amount of the abatement decreasing as the size of the

permanent institution seems to establish a certain presumption in its favor. To be sure, in politics and finance, however it may be in the realm of nature, mere survival can hardly be said to constitute any very conclusive proof of fitness. Conservatism or other and perhaps worse influences may, as we know too well, perpetuate old institutions after they have become ill-adapted to changed conditions or even laden with abuses and injustice. The system of state and local taxation in the United States might be cited as a case in point. But there are no indications that the English income tax is thus becoming antiquated or that it contains such inequalities or defects as would justify a demand for its abolition or radical reform. Like most taxes, it has first and last given rise to complaint on the part of the taxpayers and to adverse criticism by statesmen, politicians, and writers on finance. Such criticism can by no means be dismissed as altogether unjustifiable. The tax has its defects, which would have to be taken into consideration were we to attempt to pass judgment on its general character and test its merits either by the standard of an ideal system or by comparison with other existing taxes, which, in turn, will be found to have other or

income rises. The result is a certain progression in the rate of the tax up to incomes of £700, after which the rate becomes uniform. Dr. Hill gives the following table:

Income	Abatement	Income Taxed	Tax at 8*d*. in the Pound	Rate per cent of the Tax
£160 (exempt)				
200	£160	£40	£1.33	0.66
250	160	90	3.00	1.20
300	160	140	4.66	1.55
350	160	190	6.33	1.80
400	160	240	8.00	2.00
450	150	300	10.00	2.22
500	150	350	11.66	2.33
550	120	430	14.33	2.60
600	120	480	16.00	2.66
650	70	580	19.33	2.98
700	70	630	21.00	3.00
750	——	750	25.00	3.33⅓
800	——	800	26.66	3.33⅓

similar defects. But however faulty or imperfect the tax may be, it has successfully withstood all criticism and opposition. Movements for its abolition or its reconstruction on different principles have, indeed, been set on foot, but they have not met with much support. Twice in the course of its history it has been made the subject of investigation by Parliamentary committees, — once in 1851 and again in 1861; but neither committee reported in favor of making any changes, and for the last twenty-five years or more there has been little to encourage any expectation that the tax will be abolished or will undergo any fundamental revision. Apparently the income tax has come to stay and is generally accepted as a justifiable and, on the whole, fairly satisfactory impost.

This result is no doubt due to a variety of causes. The tax is, as we have seen, a highly convenient fiscal resource for the government. It is regularly productive of a large amount of revenue, and can be made to respond quickly to the needs of special emergencies. Taken in connection with the other portions of the English system of taxation, it conduces to a just distribution of the public burdens and carries out the generally accepted principle that taxes on articles of general consumption should be supplemented by direct taxes on property or income. Politically it occupies a strong position since, in its incidence, it is confined mainly to the wealthy or well-to-do classes, which constitute but a small proportion of the total population; and consequently there will be little disposition on the part of the great majority of voters to join in any movement for its abolition. But after all due allowances have been made for these factors, it will be found, I think, that the success of the tax in surviving the test of experience is in no small degree due to the method by which it is assessed and the manner in which the assessment is carried out through the agency of competent officials. Probably this as much as anything else explains why, notwithstanding the great changes which have taken place in economic and industrial conditions, and the effects which these changes have produced on the forms in which property is held and the way in which the income of society is produced and distributed, the income tax has continued to be assessed, producing apparently better results and giving rise, on the whole,

to less complaint at the present time than it did in the earlier period of its history.

II. The Five Schedules

For the purposes of the assessment the different kinds of taxable income are classified under five different divisions or schedules:

Schedule A covers the income arising from the ownership of land or houses. It includes the rental value of premises occupied by the owner as well as the rents received by the landlord from the tenant.

Schedule B applies to the income from the use or occupation of land, *i.e.*, the income received by the cultivator of the land, whether he is the owner or the tenant.

* * * * * * *

Schedule C comprises the interest, annuities, or dividends payable in the United Kingdom on government securities, British, colonial, or foreign.

Schedule D includes the income from trades, professions, and business, from colonial or foreign possessions, from the stock or bonds of colonial or foreign corporations, and from any other sources which are not specifically included in any other schedule.

Schedule E consists of the salaries, annuities, or pensions received by the officers and employees of the state and of incorporated companies.

This classification is not employed for the purpose of making any distinctions in the rates at which the different kinds of income are taxed. So far as the rate is concerned all income is treated alike. The distinctions relate to the manner in which the income is assessed. It would seem that those who framed this measure of taxation came to the conclusion that that process of assessment which was calculated to produce the best results when applied to one form of income could not, without more or less modification, be as advantageously applied to another. At any rate we find that the assessment is regulated by distinct rules for the different schedules, and that there is consequently considerable diversity in the process and the machinery by which

the income is ascertained and taxed. So this classification may be regarded as having been devised with a view to adjusting the process of assessment to the kind of income to be assessed. The result is a complicated system. Simplicity has been sacrificed in order to secure this adaptation of the means to the end.

In all this diversity, however, one underlying principle has been introduced and applied so far as practicable. It is the principle of assessing the sources of income. This constitutes the distinguishing feature of the English income tax. So far as practicable the income is assessed where it arises and the tax is collected by stoppage at the source. Thus the tax on the landlord's income is assessed to and collected from the tenant, who then deducts it from the rent. In like manner the creditor's income is reached by an assessment upon the gross income or profits of the debtor, who deducts the tax from his interest payments. The right to deduct the tax from rent or interest is conferred by statute, and any contract intended to abrogate it is void. The stockholder's income is reached by assessing the tax upon profits of the corporation, and thus producing a corresponding diminution in the dividends which he receives. The five schedules constitute a classification which has been prepared with a view to reaching the sources of income so far as possible. The diversity in the nature of the sources necessitates considerable diversity in the process and machinery by which this principle of assessment is applied.

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There are two important advantages which the English method of assessing income at the source possesses over an assessment upon individual incomes. In the first place the taxpayer is, as a rule, relieved from the necessity of disclosing for the purpose of taxation the exact amount of his income. He is required, to be sure, to disclose the gross amount which passes into his hands from certain specified sources; but he need not distinguish what proportion of this is *his* income, to be expended as he pleases, and what proportion he is required to pay over to other people; nor need he reveal how much income he receives from other sources. It is only when he wishes to claim the exemption or abatements which the law allows on individual incomes which come within certain specified limits that he is obliged to

give a complete and exact statement of his income. Leaving such cases out of account, it will be found that under this system of taxation a resident of England will be called upon to declare the rental value of the house which he occupies or the farm which he cultivates; he will likewise be required to declare the amount of income yielded by any business, trade, or occupation in which he may be engaged, and the amount received without deduction of the tax from any foreign investments; but he need not state how much of the sum so declared is absorbed by payments of interest on personal debts or borrowed capital or by payments of rent; and he need not reveal how much income he derives from the stock or bonds of domestic corporations, or from securities of the British government, or from lands or houses owned by him and leased to tenants. Consequently his aggregate net income may be a good deal more or it may be a good deal less than the sum which he is required to declare.

The other advantage which the system possesses is found in the ease and certainty with which it reaches the income subject to taxation. It is obvious that the opportunities for evasion will be greatly diminished, or entirely removed, if the income can be taxed before it comes into the hands of the person who is entitled to enjoy it; or, if there is still sufficient opportunity for evasion, the inducement to take advantage of it may be lacking so far as the person who is held responsible for the tax and required to make a return of the income is concerned. Under this system of assessment there is, in fact, a large amount of income in regard to which evasion is impossible. This is the case with the income paid out of the revenues of the state which imposes the tax. In the English system the tax on public annuities and on dividends or interest on the public debt is simply deducted from these payments as they are made. In the same way the tax is withheld from the salaries and pensions paid in the public service. Hardly less certain is an assessment on the profits of corporations in reaching the incomes of the stockholders and bondholders.[1]

[1] As Dr. Hill explains in a later chapter not reproduced here, corporations are required to deduct the tax from the dividends and interest paid to holders of their securities. Thus of the total yield of Schedule D about one half, representing the taxes paid by corporations, is collected by methods that make evasion impossible. — Ed.

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It is not possible, however, to apply this principle of assessment at the source of all kinds of income. In the first place the source may be inaccessible to the government imposing the tax. This is the case with the income from investments or possessions in foreign countries or in other states. But while this income cannot be reached at its source, the attempt is made, under the English system, to reach some part of it on its way from source to destination by requiring any banker or agent in Great Britain who may be intrusted with the payment of interest or dividends on foreign securities to account for and pay the tax on the sums passing through his hands in this way. Again there is considerable income which may be said to remain where it arises, the source not being distinguishable from the destination. The "first possessor" of it is also "the ultimate proprietor." This is generally true of the incomes obtained by the exercise of a trade, the practice of a profession, and the private, as distinguished from the corporate, management of business in general. It is also true of the income derived from the capital employed by the owner in his own profession or business; and of the income represented by the rental value of land or houses in those cases in which the owner is also the occupier.

As regards these descriptions of income, then, it is not possible to distinguish for the purpose of taxation between source and destination. The assessment will have to be made upon the person who receives and enjoys the income and who will consequently profit by any evasion of the tax. But while in these cases the person on whom the tax is assessed is not without the inducement to evade it, he may, nevertheless, lack the opportunity. Whether evasion is possible and easy or not will depend upon circumstances and particularly upon the character of the income. The assessment of houses and lands in the locality where they are situated, or of the income which they represent, is always a comparatively simple matter, affording little chance for evasion whether the tax be levied upon the owner or the tenant; and under the English system the assessment of the farmer's income is equally simple, because for the purpose of taxation the income is assumed to be equivalent to a

certain proportion (one third as the law now stands) of the annual or rental value of the farm, so that ordinarily it is not necessary to undertake to ascertain the profits which the farmer actually obtains.[1] Then, too, many of the moderate or smaller incomes earned in a trade, profession, or business can be estimated with so close an approach to accuracy that there is practically little chance for concealment.

On the other hand, there are many cases in which an accurate or adequate assessment is hardly possible without the assistance of information furnished by the person who possesses the income on which the tax is to be levied. Here both the inducement and the opportunity to evade some part of the tax are present and are, as it were, coincident, — the person who has the opportunity being the person who profits by the evasion. There is, in fact, considerable income which will hardly be discovered and taxed unless the recipient of it is honest enough to reveal it. This applies to the returns from foreign investments, where the tax has not been deducted by any agent, and must, therefore, be collected, if it is collected at all, from the investors themselves. In other cases the existence of the income may be obvious enough, but its amount cannot be accurately or perhaps even approximately estimated unless the assessors can avail themselves of the taxpayer's knowledge of his own affairs. This is, to a considerable extent, true of the larger professional and business incomes.

The opportunity for evasion, then, which is, perhaps, the strongest objection that can be urged against the direct taxation of income, has not been entirely eliminated under the English system, but its scope has been very much restricted. Probably more than four fifths of the tax collected is assessed in such a way or under such conditions that evasion is, broadly speaking, out of the question. This estimate includes all the tax assessed in Schedules A, B, C, and E, and more than half of that in Schedule D. But as for the remainder, it is assessed under conditions which do not wholly preclude the possibility and likelihood of more or less evasion, the income being of such a

[1] Since 1887 the farmer has had the option, however, of being assessed upon the profits actually received from his farm; but he does not generally avail himself of this alternative, perhaps because it is not often for his advantage to do so.

nature that the assessors are, to some extent, dependent upon the declarations which are required of interested taxpayers. Consequently, as regards this portion of the tax, the problems and difficulties which are involved in securing reliable declarations and making an adequate assessment are very much the same as those which arise in connection with the other and more usual form of income tax, which is assessed upon the aggregate net incomes of the individual taxpayers; and it will be found, in fact, that the process and machinery of assessment employed in Schedule D would be equally applicable to a tax which was wholly assessed upon the individual owners of the taxable property or income.

45. The Income Tax in the American Commonwealths. — Various American states have experimented with general or partial income taxes, and their experience has been summarized by Dr. D. O. Kinsman as follows: [1]

We shall now give a brief *résumé* before presenting our conclusion. We cannot charge the commonwealths with slighting the income tax. Of the forty-five states, sixteen have made legislative provision for it, either in a general or special form; of about one hundred constitutions passed by the states, thirteen, representing eight states, have made special provision for its use; and of some forty state tax commissions, which have been appointed by the different states, seven have treated it in their reports.

The use of the income tax proper [2] began about 1840 and has continued to the present time. Its history has been marked by three periods of special activity: one from about 1840 to

[1] The Income Tax in the Commonwealths of the United States, 110 *et seq.* In Publications of the American Economic Association, Third Series, Vol. IV (1903). Reprinted with consent of the author and the Economic Association.

[2] In the seventeenth and eighteenth centuries most of the colonies levied, for longer or shorter times, a partial income tax on "faculty," trades, professions, or occupations. This was designed to supplement the tax on property, but was of little financial significance. In some cases, as in Massachusetts and South Carolina, it survived until the nineteenth century, and developed into an income tax. For the early history of colonial and state income taxes, see Kinsman, Income Tax, 1–16; Seligman, The Income Tax in American Colonies and States, in *Political Science Quarterly*, June, 1895. — Ed.

1850, during which decade six states introduced the tax; another from 1860 to 1870, during which decade seven introduced it; and a third from about 1895 to the present, which has been marked by a revival of the movement. Of the sixteen states that have employed it, six are still using it — Massachusetts, Virginia, North Carolina, South Carolina, Louisiana, and Tennessee.

Massachusetts has had the longest experience with the tax, extending from 1643 to the present time. South Carolina's experience began in 1701 and, with the exception of about thirty years, has extended to the present. Pennsylvania levied the tax from 1841 to 1871; Maryland, from 1842 to 1850; Virginia, from 1843 to the present; Alabama, from 1843 to about 1886; Florida, from 1845 to 1855; North Carolina, from 1849 to the present time. With but one exception the states introducing the tax between 1860 and 1870 employed it for only very short periods. Missouri employed the tax from 1861 to 1866; Texas, from 1863 to 1868; Georgia, from 1863 to 1866; West Virginia, during 1863; Louisiana, the one exception, from 1865 to the present time; Kentucky, from 1867 to 1872; Delaware, from 1869 to 1872. Tennessee tried the tax in 1883, but then, like Kentucky, only to a very limited extent.

Two causes have led to the introduction of the income tax: the demand for greater justice in the distribution of the burdens of taxation, and the need of increased revenue. A third cause, a desire to regulate the business from which the income is derived, has operated in a few instances. The need of revenue was the dominant force leading to the introduction of the tax in the period between 1840 and 1850, and also in that between 1860 and 1870. In the first period this need was due to the enormous state debts resulting from extensive internal improvements; in the second period, to the heavy expenses incurred by the Civil War. It must be recognized, however, that the democratic influences which were felt in almost every department of political life about 1840 had not a little influence on the movement during the earlier period. During the present period the demand for justice appears to be the dominant force, although in South Carolina, as we have seen, the financial need is having weight.

The states employing the tax have spared neither time nor ingenuity in attempting so to frame the laws as to make the tax effective. Every possible method has been tried. The tax has been levied as a general income tax upon all forms of income, and as a special income tax upon one or more forms of income; without regard to the source of the income and modified according to the source; as an apportioned tax, and as a percentage tax. The rate has been made proportional, progressive, and partly proportional and partly progressive. The exemption has been a fixed sum applied to all income and a sum varying with the form of income and with particular classes of individuals. The administration of the law has been under the direct supervision of the central government, and it has been left to the option of the local units. The tax has been employed strictly as a war measure, as a peace measure, and as both.

Of all the states using the tax, six have levied it as a general income tax, affecting all forms of income — rent, interest, wages, and profits. These states are Massachusetts, South Carolina, Virginia, Alabama, North Carolina, and Texas. The scope of the tax in Massachusetts, however, has varied with the different local interpretations placed upon the law.[1] The remaining ten states have each taxed some one or more of the four forms of income. All of them except Georgia, Tennessee, and Kentucky have taxed incomes from personal services, salaries being especially mentioned; seven of them, all except Florida, Tennessee, and Kentucky, have taxed profits. Five, Delaware, West Virginia, Kentucky, Tennessee, and Missouri, have taxed interest. The rate of the tax has usually been proportional, although six of the states have made use of the progressive rate.

An exemption has been very generally allowed, varying both in the different states and at different times in the same state. When a fixed sum has been allowed, it has been usually from \$300 to \$2500, \$500 and \$1000 being the most common amounts.

[1] Since 1873 the Massachusetts law has provided that "Income from an annuity, from ships and vessels engaged in the foreign carrying trade, and so much of the income from a profession, trade, or employment as exceeds the sum of two thousand dollars a year" shall be included in the assessment of personal property under the general property tax. Income derived from property already subject to taxation is not to be taxed. *Cf.* pp. 17–28 of Dr. Kinsman's monograph; also Report of the Massachusetts Tax Commission of 1897, pp. 10–11. — Ed.

The exemption at present allowed in South Carolina is $2500. Many of the states have provided for special exemptions, such as the expenses of the business from which the income is derived and the incomes of particular classes of individuals, such as ministers of the gospel, state judges, and certain classes of laborers.

The administration of the tax has been much the same in all the states. It has been assessed, as a rule, by the local assessors and collected by the local tax collectors. The laws have required that the tax should be levied by self-assessment, almost invariably under severe penalties for failure to comply.

The revenue derived from the income tax has been insignificantly small. For instance, Alabama in 1882, during the period of her most successful experience, received an income tax of only $22,116 out of a state tax of over $600,000. In 1899 North Carolina's income tax amounted to only $4399 out of a total tax of $723,307. Virginia in 1899 received only $54,565 from this source, while her state tax amounted to $2,132,368. South Carolina in 1898, while levying a state tax of about $1,000,000, received only $5190 from her tax upon incomes.[1]

The attitude of the state courts toward the income tax has been one of sympathy. In the few cases upon the subject brought before them they have upheld the tax. Had all forces been as active in support of the system as the state courts, the tax would undoubtedly have been a success.

Of the thirteen state constitutions providing for the taxation of incomes, Texas has adopted three; one in 1845, a second in 1869, and a third, still in force, in 1876. Louisiana has also adopted three constitutions making special provision for the tax; one in 1845, another in 1852, and a third in 1868. The constitutions of 1879 and of 1898 failed to make such a provision. Virginia has provided for the tax since 1851, the constitution of that year and also that of 1870, still in force, expressly allowing the tax. The next state to provide for the

[1] In the cities of Massachusetts it was ascertained in 1896 that $1,891,742,000 of property was assessed for taxation. Of this sum, only $422,048,000 was personal property; and of this amount of personalty, only $3,880,000 was income. Of the 32 cities, 11 reported no incomes assessed, Boston, Worcester, Cambridge, and other large cities being of this number. — Ed.

tax in her constitution was North Carolina in 1868. Tennessee, in her constitution of 1870, still in force, incorporated a similar provision. California did likewise in her constitution of 1879, now in operation. Kentucky followed in 1891, and South Carolina, the last of the states to make such provision, in 1895.

* * * * * * *

A careful study of the history of the tax leads one to the conclusion that the failure has been due to the administration of the laws. This conclusion is borne out by both the admissions of the advocates and the assertions of the opponents of the tax, and is corroborated by the reports of tax commissions. The causes operating to produce this failure in administration appear to have been four: the laws themselves have been defective in the provisions for their own administration; the officials have been lax in the enforcement of the laws; the taxpayers have been persistent in evading them; and the nature of some incomes has made them especially difficult to reach. The income tax laws thus far, failing to recognize the weakness of the average taxpayer, have allowed him to return his own income. Some argue that to employ any other method would be undemocratic and that public sentiment would never submit to it. However, although the public has always opposed any inquisitorial system, the opposition has been often due rather to the fear that it may attain the end sought than that it is counter to the spirit of democracy. Often the taxpayer has something he wishes to conceal and calls on the "spirit of democracy" to help him out. We have yet to learn of a plausible argument in support of the assertion that the income tax is more inquisitorial than other forms of direct taxation. The income tax has succeeded in nations quite as democratic as the United States. Other methods than self-assessment have been employed successfully, both by foreign nations and to a limited extent by some of our own states. The use of the method of self-assessment has been due, not to public demands, but largely to the indifference of legislators. However, it is not to be condemned except that it furnishes the means by which the taxpayer, if he wishes to do so, may escape the tax.

The laxness of the officials in the enforcement of the laws doubtless also has had much to do with the failure of the income

tax. Although the laws have usually required the assessors to demand from each taxpayer a full statement of his income and to enforce their demand by a severe penalty, they have not only failed to do this, but in listing the individual's property have also entirely neglected his income or assessed it so low as to make the tax derived therefrom unimportant. Before we can hope for a successful taxation of incomes, officials must be faithful in the performance of their duty.

The taxpayer also has contributed much to the failure of the income tax. Not only has he taken advantage of every opportunity to escape it, but he has also exercised his ingenuity to contrive means of evading it. The taxpayer with an elastic conscience and a good opportunity has usually succeeded in escaping the tax upon such property as could be concealed.

The nature of income is such as to make concealment comparatively easy. Much income is received in such form as to make it quite impossible for any one except the recipient to know its amount, or at least to make more than a mere estimate, and even the recipient, in many instances, would find it quite impossible to be accurate. . . .

As a result of our study we conclude that the state income tax has been a failure, due to the failure of administration, which, in turn, may be attributed to four causes: the method of self-assessment, the indifference of state officials, the persistent effort of the tax-payers to evade the tax, and the nature of the income. The tax cannot be successful so long as taxpayers desirous of evading taxation are given the right of self-assessment. Since all attempts to change the method of self-assessment have failed and the nature of industry in the states is at present such as to make impossible the assessment of a general income tax at the source, we are forced to the conclusion that, even though no constitutional questions should arise, failure will continue to accompany the tax until our industrial system takes on such form as to make possible the use of some method other than self-assessment.

46. Federal Taxation of Incomes (1861–1872). — Our federal government has made two attempts to tax incomes; the first during the Civil War, the second in 1894. The income tax of

the Civil War was established in 1861 and was discontinued in 1872. Its history is outlined by Dr. F. C. Howe, as follows:[1]

By the provisions of the measure, a tax of 3 per cent was imposed on all incomes in excess of $800, from whatever source derived, save that upon any income derived from United States securities $1\frac{1}{2}$ per cent should be levied. Upon the incomes, dividends, or rents accruing upon any property or securities in the United States, but held by citizens resident abroad, there was to be charged a discriminating tax of 5 per cent, save upon so much of the income as was derived from federal securities. The tax was assessable on the first of January; and in computing income, all national, state, and local taxes were to be first deducted. The duty was self-assessed upon schedules prepared for the purpose, and was based upon receipts for the preceding year, irrespective of their source. In case of failure on the part of the taxable to make such return, the assessor was empowered to estimate the income, and to add thereto 10 per cent as a penalty for the default.

The tax was assessed but once under this measure, when Congress, reassembling again in regular session, passed modifications which substantially repealed its provisions. By these alterations the exemption was reduced from $800 to $600; the rates were rendered slightly progressive, incomes above $600 and below $10,000 paying 3 per cent on the excess above the former sum, those above the latter sum paying 5 per cent. The rates upon incomes from special sources remained unchanged. In order that the tax might be relieved of the objectionable feature by which publicity was given to incomes, collectors were instructed by the commissioner that returns of incomes should not be open to inspection by the public, a ruling which laid the tax open to all sorts of evasions, and subsequently induced its reversal by the commissioner.

These rates remained in force for two years, when, in response to the recommendations of the commissioner, and the absorbing

[1] F. C. Howe, Taxation in the United States under the Internal Revenue System, 90–102 (New York, T. Y. Crowell and Company, 1896). Reprinted with consent of the author and by special arrangement with the publishers.

demand for revenues, the comprehensive measure of June 30, 1864, was passed, by which the duties were considerably increased, and the rates rendered more strongly progressive. By this Act incomes between $600 and $5000 were taxed at the rate of 5 per cent, those from $5000 to $10,000 at $7\frac{1}{2}$ per cent, while all incomes in excess of the latter sum were rendered dutiable at the uniform rate of 10 per cent. The Act further provided that any revenues derived from United States securities should be included in estimating incomes under the section, and that any net profits realized from sales of land were to be returned as income, while any losses incurred in the same way were to be deducted. In a like manner the householder was permitted to deduct the annual rental value of his homestead, whether occupied as tenant from another, or held in his own right. The measure specified with great precision the methods for the computation of annual gains, and required the assessor to secure from each taxable an itemized account of his revenue for the preceding year. In the case of the farmer the requirement was extremely burdensome; for it demanded a minute return of all "incomes and gains derived from the increased value of live stock, whether sold or on hand, and the amount of sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay, grain, or other productions of the estate of such person sold." Such demands were somewhat onerous upon the citizen inclined to make an honest return; while, to those aiming to evade payment, the privilege of deducting house rent, wages, interest upon incumbrances, and expenditures for repairs, opened an avenue for evasion and fraudulent return; and it occasions no surprise that, as a result, the tax was unpopular, the returns incomplete, and the burdens unequally distributed. This measure had scarcely received the signature of the President, when Congress, by joint resolution, imposed a special income tax of 5 per cent upon all incomes in excess of $600, which was collected in addition to the regular income duty of that year. It was assessed but once, in October, 1864, the war closing early in the year following, and produced $29,381,862, a striking commentary on the improvement in the method of assessment, as well as an indication of the loyalty and patriotism of the people.

The classifications of the law of 1864 remained in force for but

one assessment, when they were again reduced to two, and all incomes in excess of $5000 were rendered dutiable at 10 per cent, all below that sum and in excess of $600 being taxable at the old rate of 5 per cent.

The war closed almost immediately after this latter modification had been made, and the imperative necessities of the treasury were in part relieved. Naturally, agitation for the immediate repeal of the tax at once commenced; but Congress wisely preferred first to relieve those subjects most oppressed by the excise. Industry was shackled, and the laws of trade unsettled, by the duplication of taxes induced by the general excise. The income tax, on the other hand, fell mainly upon accumulated wealth, and, in the mind of the Revenue Commission,[1] would "probably be sustained with less detriment to the country than any other form of taxation, the excise upon spirituous and fermented liquors, and tobacco, possibly excepted." It is this impotency of the income tax to affect prices and industry, as well as its non-interference with the free employment of capital, which renders it such a fit emergency tax. It is, in addition, elastic, and capable of immediate and indefinite expansion in time of temporary necessity.

Unfortunately, the report of the Revenue Commission, so replete and satisfactory in other respects, offers but little information in regard to the operations of this tax. Its temporary retention was, however, advocated; but the element of progressivity was deemed to be an unjust discrimination, and a "tax on the results of successful industry and business enterprise." The commission therefore recommended the repeal of this discrimination, and the imposition of a uniform rate of 5 per cent on all incomes in excess of $1000, which sum was held to be no more than the equivalent of $600 at the time when the tax was first imposed, inasmuch as the advance in the prices of all commodities had greatly enhanced the cost of living. The report further advised that deductions for house rent be no longer allowed, or, if permitted, that they be limited to $300; for such excessive rentals had been permitted by the assessors in the past, that in

[1] In 1865 Congress appointed a Revenue Commission, of which David A. Wells was one of the members, to consider the best methods of reducing the burdensome taxes imposed during the war. — Ed.

New York alone the estimated losses to the revenue by reason of this permission exceeded $2,000,000 a year.

Congress acceded to the report in so far as it related to the raising of the exemption to $1000, with a uniform rate of 5 per cent upon all incomes in excess of that sum, while the proviso was added thereto that the tax should expire in 1870. This latter provision was not observed, however; for Congress, fearing a deficiency, later extended its operations for two years more, but with the exemption increased to $2000. It is of interest to note that under these later provisions the tax became even more unpopular than it had been before, as it assumed in the eyes of the payer the form of a compulsory tribute imposed upon large wealth. In addition to the exemption of $2000, as well as all taxes paid, deductions were also permitted, as in earlier measures, for all losses "actually sustained from fires, floods, shipwrecks, or that occurred in trade; the amount of interest paid during the year, the amount paid for rent or labor to cultivate land," as well as any expenditure incurred in repairs other than those for improvement.

The effect of these provisions was greatly to impair the productivity of the tax. Thus, in 1871, the number of taxables returned was but 74,775, while in the following year (the last of its operation) they fell off still further to 72,949; while the receipts for the same years were $14,434,949 and $8,146,686 respectively.

The income tax has always been unpopular with certain classes. It is indicted as invading the sanctity of the most private affairs, as being inseparable from inquisitorial scrutiny into business relations, and an insufferable intrusion into those affairs of the individual which are in a sense sacred, and which in the past had been exempted from the visits of the taxgatherer. It is further alleged that a tax which offers such opportunities for evasion is a charge upon honesty and patriotism, and a premium upon perjury.

Unquestionably the tax was exposed to widespread evasion, especially in the large cities. Such complete confidence was reposed in the individual that evasion was an easy matter; and the instructions of the commissioner, early in 1863, that the returns should be open for inspection only to officers of the

revenues, simply facilitated it. By a later ruling, however, all returns were thrown open to the public, "in order," as the commissioner said, "that the amplest opportunity may be given for the detection of any fraudulent returns that may have been made." That this ruling had its expected result may be questioned; for it induced other evils, which probably offset any stimulus to honest returns.

In order to facilitate the collection of the tax, extensive use was made of the principle of stoppage at the source. Corporations of a certain kind announcing dividends were directed to deduct the tax, and pay the same to the collector before the distribution of earnings to the stockholders. By this means a large portion of the tax was collected before the income reached the hands of the individual, while fradulent returns were checked, and the necessity of supervision reduced to a minimum. It was estimated that the cost of returning this portion of the tax did not exceed one fifth of one per cent, a fact which led the commissioner to recommend that the system of stoppage be extended to all corporations for profit declaring dividends, as later provided in the measure of 1894. How efficient this method was will appear from the fact that in 1865, when the total receipts from incomes were $32,050,017, nearly 40 per cent, or $11,346,018, was turned into the treasury from the earnings of banks, canal, railroad, insurance, and turnpike companies and federal employees.

But despite the fact that the income tax was unpopular, and the returns depleted by fraud and evasion, it proved one of the most satisfactory, from a purely fiscal point of view, of the many expedients hit upon by Congress.

In 1865 it produced as much as liquors, both malt and distilled, and tobacco; while in the year following it returned nearly 40 per cent more than these combined sources. In the former year over 15 per cent of the entire internal revenue receipts was derived from this source. In 1866 over 23 per cent, and in 1867 over 24½ per cent.

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Following the Act of March 2, 1867, which increased the exemption allowed to $1000, the number of taxables returned manifested a considerable falling off, while the receipts were

diminished by about one half. During the four years of the operation of the revised rate, the average number of taxables returned was 267,210, of which number nearly 60 per cent paid taxes in excess of $20.

As a crowning enactment of this long period of experimentation, the limit of exemption was increased in 1870 to $2000, with the avowed intention of relieving all save comparatively large incomes from its operation. At the same time the rate was reduced to $2\frac{1}{2}$ per cent, at which point it remained until 1872, when the tax expired by limitation.

From the experience of these years it is not possible to draw any absolute conclusions as to the availability of the income tax for federal purposes, inasmuch as the measure of a tax lies largely in its fitness to conditions and the times; and the defects of the duty during this period were largely administrative in character, traceable to the inefficiency of its administration. The entire service was experimental, the men untrained, and the machinery imperfect; and, had the tax been ever so well suited to our political and social conditions, its productivity would have suffered greatly from this cause.

47. The Income Tax of 1894. — On account of a deficiency in the revenues and in order to facilitate revision of the tariff, another federal income tax was established in 1894. Dr. Howe gives the following account of this tax,[1] which was speedily declared to be unconstitutional:

The provisions of the measure relating to incomes were modeled upon the later war legislation. They provided that the tax should be first assessed on or before the first Monday in March, 1895, computed on the incomes received during the year 1894. The duration of the measure was limited to five years. All persons having an income in excess of $3500 were required to make a verified return to the collector, as were all persons acting in a fiduciary capacity; and in estimating the income of any person for this purpose there was to be included: (1) all

[1] Taxation in the United States, 233–236. Reprinted with consent of author and publishers.

interest received upon stocks, bonds, and other securities, save such bonds of the United States as were exempt from federal taxation; (2) all profits realized within the year from sales of real estate purchased within two years previous to the close of the year from which income is estimated; (3) interest received or accrued upon evidences of indebtedness, whether paid or not, if good and collectible; (4) the amount of all premium on bonds, stocks, etc.; (5) the amount of sales of live stock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, or other vegetable, or other productions, being the produce of the estate, less the amount expended in the raising or purchase of such produce, as well as any part consumed directly by the family; (6) money, and the value of all personal property acquired by gift or inheritance; (7) all other gains, profits, and income from any source whatsoever, except so much as has been already taxed through the disbursing officer of the government or of a private corporation. In computing such returns, however, the following deductions were also permitted in addition to the minimum exemption of $4000: (1) the necessary expenses actually incurred in carrying on any business, occupation, or profession; (2) all interest due or paid within the year on existing indebtedness; (3) all national, state, county, school, and municipal taxes; (4) losses actually sustained during the year incurred in trade, or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; (5) debts ascertained to be worthless. No deductions were permitted for expenditures for improvements. In case the taxable neglected or refused to make such return, the collector was authorized to make up a list from the best information available, and to add thereto 50 per cent as a penalty, and in case of fraudulent return, 100 per cent. Appeal therefrom was permitted to the collector of the district, and from him to the Commissioner of Internal Revenue.

The principle of stoppage at the source was more widely extended in this measure than ever before; and all banks, trust companies, saving institutions; fire, marine, life, and other insurance companies; railroads; canal, turnpike, telephone, telegraph, express, electric lighting, gas, water, street railway companies; as well as all other corporations or associations doing

business for profit in the United States, no matter how created or organized (but not including partnerships), were directed to deduct the tax of 2 per cent upon all profits and net incomes before the payment of the same to stockholders or additions made to surplus. And net profits for the purpose of estimating the tax were to include any amounts paid to stockholders, or carried to the account of any fund, or used for improvements or other investments.[1] The same principle was applied to federal salaries in excess of $4000, as well as any salaries paid by corporations to their employees in excess of that sum.

The Act departed from earlier legislation in yet another and very important particular; for it forbade under heavy penalties the divulgement by the officers of the revenue of the incomes, losses, or returns of any taxable, whether a private corporation or an individual.

All returns were to be listed upon blanks provided for the purpose on or before the first Monday in March, and were to be paid before the first day of July of each year.

The law doubtless contained many imperfections, and in many places was so worded as to cause irritation to the payer, and to open wide the door for evasion, fraud, and false swearing. It reposed great powers, moreover, in a politically appointed service. These imperfections were particularly noticeable in the deductions allowed. For instance, as to what are "necessary expenses incurred in carrying on business," "losses actually sustained during the year," "debts ascertained to be worthless," there lay a possibility of wide divergence of opinion. The provision that corporations should deduct the tax from the salaries of their employees was absolute, notwithstanding the fact that they might have been entitled to deductions which would bring their incomes below $4000. Corporations were likewise compelled to pay the tax upon their net earnings, irrespective of whether the recipient of the dividends had an income of $4 or $40,000. Moreover, the collector was granted the widest latitude and most unusual powers. He was empowered to pass

[1] The Act specifically exempted all organizations of a religious, charitable, or educational character, fraternal or beneficial orders, building and loan associations, and savings banks and insurance companies of a strictly mutual character. Nor did it apply to states, counties, or municipalities.

upon interest due and payable; to increase the return of the individual subject, however, to appeal; and to make up a taxable's income from the best information available. These but indicate some of the difficulties which would have beset the administration of the measure, as well as the individual honestly desirous of making a fair return. Had we a trained service, these objections would lose much of their seriousness; but, with collectors appointed for partisan service rather than merit, there is reason to believe that this power would have become a means of unjust discrimination. It certainly offered great opportunities for corrupt collusion with taxpayers.

48. The constitutionality of the law of 1894 was promptly attacked, and the Supreme Court, after two hearings, declared the act invalid before it went into operation. At the first hearing the court decided [1] that the tax imposed upon the income of real estate was unconstitutional because such a tax was a direct tax within the meaning of the Constitution, and should have been levied by the rule of apportionment which the Constitution prescribes for direct taxes.[2] It also declared that the tax could not be imposed upon the income from state or municipal bonds, since the national government cannot tax the power of the state or local governments to borrow money. At the second hearing the whole act was overthrown on the ground that a tax on the income from personal property is direct as well as a tax on the income from real property; and that the failure to provide for the apportionment of the tax on the income from real and personal property invalidated the entire law.[3] Upon this point the court said:

The power to lay direct taxes apportioned among the several states in proportion to their representation in the popular branch of Congress, a representation based on population as ascertained

[1] 157 U. S., 429.

[2] The Constitution says: "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers." Art. I, § 2.

[3] 158 U. S., 601.

by the census, was plenary and absolute; but to lay direct taxes without apportionment was forbidden. The power to lay duties, imposts, and excises was subject to the qualification that the imposition must be uniform throughout the United States.

Our previous decision was confined to the consideration of the validity of the tax on the income from real estate, and on the income from municipal bonds. The question thus limited was whether such taxation was direct or not, in the meaning of the Constitution; and the court went no farther, as to the tax on the income from real estate, than to hold that it fell within the same class as the source whence the income was derived, that is, that a tax upon the realty and a tax upon the receipts therefrom were alike direct; while as to the income from municipal bonds, that could not be taxed because of want of power to tax the source, and no reference was made to the nature of the tax as being direct or indirect.

We are now permitted to broaden the field of inquiry, and to determine to which of the two great classes a tax upon a person's entire income, whether derived from rents, or products, or otherwise, of real estate, or from bonds, stocks, or other forms of personal property, belongs; and we are unable to conclude that the enforced subtraction from the yield of all the owner's real or personal property, in the manner described, is so different from a tax upon the property itself, that it is not a direct, but an indirect tax, in the meaning of the Constitution.

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We know of no reason for holding otherwise than that the words "direct taxes," on the one hand, and "duties, imposts, and excises," on the other, were used in the Constitution in their natural and obvious sense. Nor, in arriving at what these terms embrace, do we perceive any ground for enlarging them beyond, or narrowing them within, their natural and obvious import at the time the Constitution was framed and ratified.

And, passing from the text, we regard the conclusion reached as inevitable, when the circumstances which surrounded the convention and controlled its action and the views of those who framed and those who adopted the Constitution are considered.

We do not care to retravel ground already traversed; but some observations may be added.

In the light of the struggle in the convention as to whether or not the new nation should be empowered to levy taxes directly on the individual until after the states had failed to respond to requisitions — a struggle which did not terminate until the amendment to that effect, proposed by Massachusetts and concurred in by South Carolina, New Hampshire, New York, and Rhode Island had been rejected — it would seem beyond reasonable question that direct taxation, taking the place as it did of requisitions, was purposely restrained to apportionment according to representation, in order that the former system as to ratio might be retained, while the mode of collection was changed.

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The reasons for the clauses of the Constitution in respect of direct taxation are not far to seek. The states, respectively, possessed plenary powers of taxation. They could tax the property of their citizens in such manner and to such extent as they saw fit; they had unrestricted powers to impose duties or imposts on imports from abroad, and excises on manufactures, consumable commodities or otherwise. They gave up the great sources of revenue derived from commerce; they retained the concurrent power of levying excises, and duties if covering anything other than excises; but in respect of them the range of taxation was narrowed by the power granted over interstate commerce, and by the danger of being put at disadvantage in dealing with excises on manufactures. They retained the power of direct taxation, and to that they looked as their chief resource; but even in respect of that, they granted the concurrent power, and if the tax were placed by both governments on the same subject, the claim of the United States had preference., Therefore, they did not grant the power of direct taxation without regard to their own condition and resources as states; but they granted the power of apportioned direct taxation, a power just as efficacious to serve the needs of the general government, but securing to the states the opportunity to pay the amount apportioned, and to recoup from their own citizens in the most feasible way, and in harmony with their systems of local self-government. If, in the changes of wealth and population in particular states, apportionment produced inequality, it was an inequality stipulated for, just as the equal representation of the states, however small,

in the Senate, was stipulated for. The Constitution ordains affirmatively that each state shall have two members of that body, and negatively that no state shall by amendment be deprived of its equal suffrage in the Senate without its consent. The Constitution ordains affirmatively that representatives and direct taxes shall be apportioned among the several states according to numbers, and negatively that no direct tax shall be laid unless in proportion to the enumeration.

The founders anticipated that the expenditures of the states, their counties, cities, and towns, would chiefly be met by direct taxation on accumulated property, while they expected that those of the federal government would be for the most part met by indirect taxes. And in order that the power of direct taxation by the general government should not be exercised, except on necessity; and, when the necessity arose, should be so exercised as to leave the states at liberty to discharge their respective obligations, and should not be so exercised, unfairly and discriminatingly, as to particular states or otherwise, by a mere majority vote, possibly of those whose constituents were intentionally not subjected to any part of the burden, the qualified grant was made. Those who made it knew that the power to tax involved the power to destroy, and that, in the language of Chief Justice Marshall, in *McCulloch* v. *Maryland*, "the only security against the abuse of this power is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation." 4 Wheat. 428. And they retained this security by providing that direct taxation and representation in the lower house of Congress should be adjusted on the same measure.

Moreover, whatever the reasons for the constitutional provisions, there they are, and they appear to us to speak in plain language.

It is said that a tax on the whole income of property is not a direct tax in the meaning of the Constitution, but a duty, and, as a duty, leviable without apportionment, whether direct or indirect. We do not think so. Direct taxation was not restricted in one breath, and the restriction blown to the winds in the other.

Cooley (On Taxation, p. 3) says that the word "*duty*" ordinarily "means an indirect tax imposed on the importation, exportation, or consumption of goods"; having "a broader meaning than *custom*, which is a duty imposed on imports or exports"; that "the term *impost* also signifies any tax, tribute, or duty, but is seldom applied to any but the indirect taxes. An *excise* duty is an inland impost, levied upon articles of manufacture or sale, and also upon licenses to pursue certain trades or to deal in certain commodities."

In the Constitution, the words "duties, imposts, and excises" are put in antithesis to direct taxes. Gouverneur Morris recognized this in his remarks in modifying his celebrated motion, as did Wilson in approving of the motion as modified. 5 Ell. Deb. (Madison Papers) 302. And Mr. Justice Story, in his Commentaries on the Constitution (§ 952), expresses the view that it is not unreasonable to presume that the word "duties" was used as equivalent to "customs" or "imposts" by the framers of the Constitution, since in other clauses it was provided that "No tax or duty shall be laid on articles exported from any state," and that "No state shall, without the consent of Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws"; and he refers to a letter of Mr. Madison to Mr. Cabell, of Sept. 18, 1828, to that effect. 3 Madison's Writings, 636.

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The Constitution prohibits any direct tax, unless in proportion to numbers as ascertained by the census; and, in the light of the circumstances to which we have referred, is it not an evasion of that prohibition to hold that a general unapportioned tax, imposed on all property owners as a body for or in respect of their property, is not direct, in the meaning of the Constitution, because confined to the income therefrom?

Whatever the speculative views of political economists or revenue reformers may be, can it be properly held that the Constitution, taken in its plain and obvious sense and with due regard to the circumstances attending the formation of the government, authorizes a general unapportioned tax on the products of the farm and the rents of real estate, although imposed

merely because of ownership and with no possible means of escape from payment, as belonging to a totally different class from that which includes the property from whence the income proceeds?

There can be but one answer, unless the constitutional restriction is to be treated as utterly illusory and futile, and the object of its framers defeated. We find it impossible to hold that a fundamental requisition, deemed so important as to be enforced by two provisions, one affirmative and one negative, can be refined away by forced distinctions between that which gives value to property and the property itself.

Nor can we perceive any ground why the same reasoning does not apply to capital in personalty held for the purpose of income or ordinarily yielding income, and to the income therefrom. All the real estate of the country, and all its invested personal property, are open to the direct operation of the taxing power if an apportionment be made according to the Constitution. The Constitution does not say that no direct tax shall be made by apportionment on any other property than land; on the contrary, it forbids all unapportioned direct taxes; and we know of no warrant for excepting personal property from the exercise of the power, or any reason why an apportioned direct tax cannot be laid and assessed, as Mr. Gallatin said in his report when Secretary of the Treasury in 1812, "upon the same objects of taxation on which the direct taxes levied under the authority of the state are laid and assessed."

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Now are we impressed with the contention that, because in the four instances in which the power of direct taxation has been exercised, Congress did not see fit, for reasons of expediency, to levy a tax upon personalty, this amounts to such a practical construction of the Constitution that the power did not exist, that we must regard ourselves bound by it. We should regret to be compelled to hold the powers of the general government thus restricted, and certainly cannot accede to the idea that the Constitution has become weakened by a particular course of inaction under it.

The stress of the argument is thrown, however, on the assertion that an income tax is not a property tax at all; that it is not

a real estate tax, or a crop tax, or a bond tax; that it is an assessment upon the taxpayer on account of his money-spending power as shown by his revenue for the year preceding the assessment; that rents received, crops harvested, interest collected, have lost all connection with their origin, and although once not taxable have become transmuted in their new form into taxable subject-matter; in other words, that income is taxable irrespective of the source from whence it is derived.

This was the view entertained by Mr. Pitt, as expressed in his celebrated speech on introducing his income tax law of 1799, and he did not hesitate to carry it to its logical conclusion. The English loan acts provided that the public dividends should be paid "free of all taxes and charges whatsoever"; but Mr. Pitt successfully contended that the dividends for the purposes of the income tax were to be considered simply in relation to the recipient as so much income, and that the fund holder had no reason to complain. And this, said Mr. Gladstone, fifty-five years after, was the rational construction of the pledge. Financial Statements, 32.

The dissenting justices proceeded in effect upon this ground in *Weston* v. *Charleston*, 2 Pet. 449, but the court rejected it. That was a state tax, it is true; but the states have power to lay income taxes, and if the source is not open to inquiry, constitutional safeguards might be easily eluded.

We have unanimously held in this case that, so far as this law operates on the receipts from municipal bonds, it cannot be sustained, because it is a tax on the power of the states, and on their instrumentalities to borrow money, and consequently repugnant to the Constitution. But if, as contended, the interest when received has become merely money in the recipient's pocket, and taxable as such without reference to the source from which it came, the question is immaterial whether it could have been originally taxed at all or not. This was admitted by the Attorney-General with characteristic candor; and it follows that, if the revenue derived from municipal bonds cannot be taxed because the source cannot be, the same rule applies to revenue from any other source not subject to the tax; and the lack of power to levy any but an apportioned tax on real and personal property equally exists as to the revenue therefrom.

Admitting that this act taxes the income of property irrespective of its source, still we cannot doubt that such a tax is necessarily a direct tax in the meaning of the Constitution.

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At the time the Constitution was framed and adopted, under the systems of direct taxation of many of the states, taxes were laid on incomes from professions, business, or employments, as well as from "offices and places of profit"; but if it were the fact that there had been then no income tax law, such as this, it would not be of controlling importance. A direct tax cannot be taken out of the constitutional rule because the particular tax did not exist at the time the rule was prescribed. As Chief Justice Marshall said in the *Dartmouth College case:* "It is not enough to say that this particular case was not in the mind of the convention when the article was framed, nor of the American people when it was adopted. It is necessary to go further, and to say that, had this particular case been suggested, the language would have been so varied, as to exclude it, or it would have been made a special exception. The case, being within the words of the rule, must be within its operation likewise, unless there be something in the literal construction so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument, as to justify those who expound the Constitution in making it an exception." 4 Wheat, 518, 644.

Being direct, and therefore to be laid by apportionment, is there any real difficulty in doing so? Cannot Congress, if the necessity exist of raising thirty, forty, or any other number of million dollars for the support of the government, in addition to the revenue from duties, imposts, and excises, apportion the quota of each state upon the basis of the census, and thus advise it of the payment which must be made, and proceed to assess that amount on all the real and personal property and the income of all persons in the state, and collect the same if the state does not in the meantime assume and pay its quota and collect the amount according to its own system and in its own way? Cannot Congress do this, as respects either or all these subjects of taxation, and deal with each in such manner as might be deemed expedient, as indeed was done in the act of July 14, 1798, c. 75,

1 Stat. 597? Inconveniences might possibly attend the levy of an income tax, notwithstanding the listing of receipts, when adjusted, furnishes its own valuation; but that it is apportionable is hardly denied, although it is asserted that it would operate so unequally as to be undesirable.

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We have considered the act only in respect of the tax on income derived from real estate, and from invested personal property, and have not commented on so much of it as bears on gains or profits from business, privileges, or employments, in view of the instances in which taxation on business, privileges, or employments has assumed the guise of an excise tax and been sustained as such.

Being of opinion that so much of the sections of this law as lays a tax on income from real and personal property is invalid, we are brought to the question of the effect of that conclusion upon these sections as a whole.

It is elementary that the same statute may be in part constitutional and in part unconstitutional, and if the parts are wholly independent of each other, that which is constitutional may stand while that which is unconstitutional will be rejected. And in the case before us there is no question as to the validity of this act, except sections twenty-seven to thirty-seven, inclusive, which relate to the subject which has been under discussion; and as to them, we think the rule laid down by Chief Justice Shaw in *Warren* v. *Charlestown*, 2 Gray, 84, is applicable, that if the different parts "are so mutually connected with and dependent on each other, as conditions, considerations, or compensations for each other, as to warrant a belief that the legislature intended them as a whole, and that, if all could not be carried into effect, the legislature would not pass the residue independently, and some parts are unconstitutional, all the provisions which are thus dependent, conditional, or connected, must fall with them."

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According to the census, the true valuation of real and personal property in the United States in 1890 was $65,037,091,197, of which real estate, with improvements thereon, made up

$39,544,544,333. Of course, from the latter must be deducted, in applying these sections, all unproductive property and all property whose net yield does not exceed $4000; but, even with such deductions, it is evident that the income from realty formed a vital part of the scheme for taxation embodied therein. If that be stricken out, and also the income from all invested personal property, bonds, stocks, investments of all kinds, it is obvious that by far the largest part of the anticipated revenue would be eliminated, and this would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way, what was intended as a tax on capital would remain in substance a tax on occupations and labor. We cannot believe that such was the intention of Congress. We do not mean to say that an act laying by apportionment a direct tax on all real estate and personal property, or the income thereof, might not also lay excise taxes on business, privileges, employments, and vocations. But this is not such an act; and the scheme must be considered as a whole. Being invalid as to the greater part, and falling, as the tax would if any part were held valid, in a direction which could not have been contemplated except in connection with the taxation considered as an entirety, we are constrained to conclude that sections twenty-seven to thirty-seven, inclusive, of the act, which became a law without the signature of the President, on August 28, 1894, are wholly inoperative and void.

Our conclusions may, therefore, be summed up as follows:

First. We adhere to the opinion already announced, that taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.

Second. We are of opinion that taxes on personal property, or on the income of personal property, are likewise direct taxes.

Third. The tax imposed by sections twenty-seven to thirty-seven, inclusive, of the act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and therefore unconstitutional and void because not apportioned according to representation, all those sections, constituting one entire scheme of taxation, are necessarily invalid.

49. The History of Federal Direct Taxes. — The income-tax decision of 1895 makes it important for the student of federal taxation to study the history of the so-called direct taxes which Congress has, upon a few occasions, apportioned among the several states according to the rule prescribed by the Constitution. The essential facts are as follows:[1]

Five years after the new government was established under the Constitution, the necessary expenditures of the United States had increased to such an extent that it was perceived by the best financiers that indirect taxation ought to be supplemented by other revenues. A direct tax was proposed in 1794 and in 1796, but Congress did not come to a decision until 1798. One of the reasons assigned for the reluctance to pass such a measure was the inequality and injustice of the constitutional requirement. The act of 1798 apportioned among the states a direct tax of $2,000,000. This was assessed upon dwelling-houses, lands, and slaves, and was collected by federal officers, without reference to state authorities. The tax was to be paid in 1800, but only $734,000 was raised in that year. In 1801 the collections amounted to $534,000 and in 1803 $207,000 was paid in. Thus, less than three quarters of the tax was raised in three years. Small payments dribbled into the treasury until 1813, when $238,000 still remained uncollected. The amount of the tax had been extremely small, when compared with the apparent needs of the government in 1798, but the difficulties of collection rendered it still more insignificant as a source of revenue. It will be seen that, if other imposts had been equally "efficacious to serve the needs of the general government," the United States would have been reduced to practical bankruptcy.

Congress did not attempt to levy another direct tax until the country became involved in the second war with Great Britain. Then the blockade of our ports caused the revenue from customs duties to fall off so heavily that internal taxes became absolutely necessary. So in 1813, Congress imposed, among

[1] The Origin and Effect of the Direct Tax Clause, by C. J. Bullock. Reprinted from the *Political Science Quarterly*, XV, 470 *et seq.*

other taxes, a direct levy of $3,000,000 upon the states. This was assessed upon lands, houses, and slaves, but the states were allowed to assume their quotas and collect the money for the United States by means of their own taxes. Seven states availed themselves of this privilege, and in the other eleven the tax was collected by the federal government. This was a most favorable opportunity for proving the efficacy of direct taxes apportioned in the constitutional manner. The emergency was alarming, the necessities of the federal treasury were perfectly clear, and no one could deny the propriety of attempting to collect the small amount of money called for under the law. The result was a deficiency of nearly $800,000 out of the total levy of $3,000,000 for the year 1814. Congress felt obliged to establish, in 1815, an annual direct tax of $6,000,000. But this measure was repealed in 1816, when, however, a tax of $3,000,000 was required for that year. These later acts differed in no essential feature from the law of 1813. The amounts required had been as follows: $3,000,000 by the act of 1813, $6,000,000 by the act of 1815, and $3,000,000 by the act of 1816. By the close of the fiscal year 1817, the payments had amounted to $10,470,000. Small collections continued until the year 1839, when the total receipts had risen to $10,984,000. The efficacy of this power of apportioned taxes can be judged from the fact that, during the years 1814, 1815, 1816, and 1817, when the returns were largest, direct taxes upon property had yielded only $10,470,000 out of a total of $100,486,000 which the government had drawn from the people by taxation. Worse even than the failure of these direct taxes for purposes of revenue were the hardships caused by their unequal assessment.

Congress made no further attempts to use this efficacious power until the nation was convulsed in the throes of a life and death struggle with domestic insurrection. In the first war revenue act of 1861, there was a provision for an annual direct tax of $20,000,000. This followed closely the lines laid down by the laws of 1813 and 1815. It was assessed upon lands and dwelling-houses, and the states were allowed to assume their quotas, if they should prefer to do so. The seceding states were included in the apportionment, so that the loyal states were asked for only $15,000,000. This was a very small amount,

when compared with the resources of the country and the needs of the federal government. All the loyal states but two assumed their quotas. The payments made, however, consisted largely of the settlement of accounts which the states held against the federal treasury for their expenses in equipping troops. By an act of 1862 the duration of the tax was limited to a single year, and all further assessments were suspended until 1865; and in 1864 the tax was practically repealed. Thus, $20,000,000 represents the total amount which Congress attempted to draw from the country by means of apportioned taxes during a struggle which required an increase of all other taxation to an extent that would have seemed absolutely impossible at the opening of the war. It will be instructive to present in a single table the payments made under the law of 1861 during the years when they were largest, and to contrast them with the receipts of the federal government from other taxes. The results, stated in the nearest thousands of dollars, are as follows:

Year	All Other Taxes	Direct Tax
1861	$39,582	$1,795
1862	49,056	1,485
1863	106,701	476
1864	212,057	1,201
1865	294,392	1,975
1866	488,274	4,200
1867	442,446	1,788
1868	355,553	
Totals	$1,988,061	$12,920

Long after the close of the war, small payments kept dribbling into the treasury, the last being credited in 1888. The total amount paid or credited up to February 18, 1888, is stated at $15,360,000. After allowing $2,125,000 for the cost of collecting the tax in the states where the quotas had been assumed, there remained an unpaid balance amounting to $2,554,000. The tax had been but partially collected in the seceding states; and this circumstance, with others, led Congress in 1891 to vote to return to the states the amounts that had been paid and to

remit the quotas that still remained due. Under this law, about $14,222,000 had been returned to the states by the close of the fiscal year 1895.

The direct tax of the Civil War, then, did not prove a more brilliant success than its predecessors. An exhibit of the net results to the United States from the exercise of the power of levying apportioned taxes may not prove uninstructive. The five direct taxes levied in 1798, 1813, 1815, 1816, and 1861 called for a total of $34,000,000. Of this amount, the government succeeded in collecting, within periods varying from thirteen to twenty-six years, the surprising sum of $28,100,000. From this, however, we must deduct the $14,222,000 returned to the states under the law of 1891. When this is done, it will be seen that, in the course of the one hundred and nine years that have elapsed since the federal government has possessed this valuable power, Congress has been able to collect the net sum of $13,880,000 from these apportioned taxes. Upon a liberal estimate, this is much less than one tenth of one per cent of the total ordinary revenues of the United States since 1789, exclusive of the postal receipts.

The direct tax of 1861 was assessed upon lands and dwelling houses; but, since all the loyal states except two assumed their quotas, it became practically a general property tax. The federal census gives the assessed value of property in each state in 1860, as well as the *per capita* assessed valuation. In order to show the inequality of assessment, Massachusetts, Rhode Island, and Connecticut are compared with Michigan, Kansas, and Minnesota. The results are embodied in the table on the opposite page, in which the *per capita* assessed valuation of all property is stated in the nearest number of dollars.

Thus it appears that a hundred dollars' worth of property was taxed in Minnesota nearly four times as much as in Connecticut; while the three Western states, in general, paid at three and one half times the rate that was imposed upon the three Eastern states.

States	Quotas of Tax	Amount of Tax *per capita*	Value of All Property *per capita*	Amount of Tax per Hundred Dollars of Property
Massachusetts .	$825,000	$0.67	$631	$0.106
Rhode Island .	117,000	.67	716	.093
Connecticut . .	308,000	.67	742	.090
Minnesota . .	109,000	.63	186	.338
Kansas . . .	72,000	.67	210	.318
Michigan. . .	502,000	.67	218	.307

We may next compute the largest possible yield of a direct tax in the United States at the present time, and the inequalities that would be caused by the attempt to levy such an impost. The census of 1890 showed the smallest *per capita* valuation of assessed property to be in North Carolina. The amount that could be collected by a direct tax must be gauged by the ability of this state to contribute to the support of the general government. In order to make the estimate of the yield of the tax as large as it could possibly be, under any circumstances, let us assume that the United States decides to ask from North Carolina an amount equal to all the taxes, state and local, which the property of the state was compelled to bear in 1890. As a matter of fact, to double the direct taxes, state and local, which property is now compelled to bear, would be a political impossibility in any section of the country; but we will suppose this to be done in North Carolina. In 1890 that state raised, for state and local purposes, the sum of $2,151,835 by *ad valorem* taxes on real and personal property. This amounted to $1.33 for each person in the state. This figure sets the limit which Congress could not exceed in imposing the collective poll taxes which the Constitution calls direct taxes. In 1890 such an apportioned tax of $1.33 would have yielded $83,287,000. If we assume a population of 70,000,000 at the present moment, we should get about $93,000,000 as the largest conceivable amount of a direct tax.

This estimate is probably two or three times as large as any tax that Congress would dare to ask for. It would impose upon the poorer states a crushing burden, and would cause an amount of injustice that cannot be readily described. Moreover, it could

never be collected, even in times of direst need, as the history of previous direct taxes has shown. If the tax should be needed for more than a single year, Congress would not venture to impose upon the poorer states more than one third or one fourth of the amount of their present property taxes. Thus, if we suppose a war, lasting four years, to call for all the resources of the country, Congress might hope to raise from twenty to thirty million dollars annually by means of this efficacious power conferred by the Constitution. This, it will be remembered, presupposes that enormous inequalities would be tolerated and that a crushing burden would be imposed upon the poorer states. It also assumes, contrary to all previous experience, that such an unjust tax could be promptly collected.

The inefficacy of the power of apportioned taxation may be further shown by another comparison. In 1890 the state and local governments raised $443,096,574 by *ad valorem* taxes upon real and personal property. If Congress could reach this property uniformly with a tax only one third as large as that imposed by state and local authorities, it could raise $147,697,000 by this means. If, on the other hand, the property of the poorest states should be taxed at one third the rate imposed for local purposes and the other states should be taxed the same *per capita* amount, as required by the Constitution, the yield would be but $31,000,000.

We may conclude this subject by examining the extent of the inequalities that would be perpetrated, if Congress should attempt to raise $93,000,000 by an extraordinary levy of $1.33 for each person in every state. For this purpose we may use the census figures of the *per capita* amounts of property assessed for taxation. At this point it may be objected that the assessed value of property is not, for all the states, a uniform proportion of the true valuation. It would be better to use figures of the true valuation of all property, if any such could be found that were anything more than the most conjectural estimates. As it is, we have only the statistics of assessed valuation available for scientific purposes. But these are sufficient in this case, because a comparison is to be made of the richer Eastern states and the poorer states of the West and South. Now it may happen, although nothing definite can be said upon the subject, that real

property, in the poorer states selected for our table, is assessed at a smaller per cent of its true value than is the case in the richer states selected. For the sake of argument, this may be conceded. But it is perfectly certain that the amount of personal property that escapes the assessor in the richer states is far greater than in the poorer states. In Kansas, Nebraska, North Carolina, and South Carolina, a far larger proportion of personal property consists of farm stock and household goods, which are readily found for the purpose of assessment. The intangible forms of personalty, which escape taxation almost wholly, are far more common in the richer states. These forms of intangible wealth have probably escaped taxation in an increasing degree; for the census shows that the *per capita* amount of personal property assessed in Massachusetts had increased by only $2 between 1860 and 1890. In Rhode Island the *per capita* assessment of personalty had decreased by $9 during the same period, and in New York it had decreased by $18. We are safe in concluding that the census tables of property assessed for taxation cannot exaggerate the differences in wealth between such states as are chosen for our table. The probability is that such differences are even greater than are shown by the figures of the census; so that our results will underestimate, rather than overestimate, the extent of the inequalities.

The subjoined table shows the *per capita* amount of assessed property in each state selected for comparison, the figures being stated in the nearest number of dollars. It also shows the amount of the tax that must be assessed upon each hundred dollars of property, in order to raise each state's quota, estimated upon the basis of $1.33 *per capita*.

States	Amount of Tax *per capita*	Value of Assessed Property *per capita*	Amount of Tax per Hundred Dollars of Property
Massachusetts	$1.33	$962	$0.138
Rhode Island	1.33	931	.142
Kansas	1.33	244	.545
Nebraska	1.33	174	.764
North Carolina	1.33	145	.917
South Carolina	1.33	146	.910

Thus the rate of taxation in Nebraska would be more than five times the rate in Rhode Island; while property in the Carolinas would bear about seven times the burden imposed in Massachusetts. It is not likely that Congress will ever perpetrate such an injustice.

CHAPTER XIII

THE IMPÔT PERSONNEL–MOBILIER

50. General Description of this Tax. — The *impôt personnel-mobilier* occupies a peculiar position in finance; nothing precisely like it can be found in the tax systems of other countries. The following is a general description of the tax:[1]

The *personnel-mobilier*, as its name indicates, is composed of two taxes, the personal tax and the *mobilier*, which in certain respects are subject to different regulations.

This tax is due, in general, from every citizen of France and every foreigner, enjoying civil rights[2] and not indigent.

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The personal tax is the same for all the inhabitants of any locality, and is equal to three days' wages. The general council of each department fixes each year . . . the average value of a day's labor for the department. It cannot, however, value it lower than fifty centimes or higher than one franc fifty centimes.[3]

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The *mobilier*[4] is assessed according to the rental value of inhabited houses. This is the legal basis of the tax; and it is not

[1] Translated from the Dictionnaire des finances, II, 849 *et seq.* (Paris, 1889–94).

[2] The following classes of persons are not included here: married women living with their husbands; or children, whether they have reached their majority or not, who live with their parents or guardians and do not have an independent income from property or labor. — Ed.

[3] In about half the communes the tax is fixed at 50 centimes per day, or 1.50 francs in all. In 1891 only 5 communes valued a day's labor at the maximum figure and placed the tax at 4.50 francs. — Ed.

[4] The tax is called the *mobilier*, since it was designed originally to reach revenue derived from personal property, and employed the rental value of a person's habitation merely as a method of estimating this form of income. It was complementary to the land tax, which reached revenue from real property. — Ed.

possible to find a satisfactory substitute, as is often attempted, in the assumed ability of the taxpayer, the income from his real estate, or the profits drawn from the soil.

51. The Working of the Impôt Personnel. — Leroy-Beaulieu gives the following account of this tax:[1]

The personal tax is joined to the *mobilier;* and the two taxes form together an apportioned tax.[2] In the apportionment the fixed rates established for the personal tax are maintained by the following process. In raising the quota of the *personnel-mobilier* due from each commune, the taxpayers are first assessed for the personal tax according to the rates fixed for the value of a day's labor. This assessment falls short of the entire amount of the commune's quota, and the balance then remaining is assessed upon the taxpayers according to the rental value of the dwellings they occupy.

The personal tax in France presents two peculiarities, one of which is met in several other countries. In communes that levy *octroi*[3] duties the quota due upon the *personnel-mobilier* may be paid in whole or in part out of the proceeds of the *octrois*. . . . If only part of the *personnel-mobilier* is raised in this way, the rest of the quota must be raised by means of the *mobilier*. It even happens, as a rule, in such cases that the persons paying the lowest rentals are exempted from the *mobilier* as well as the personal tax.

It is easy to understand the reasons which in France lead municipal councils to do away with a direct tax, even though it is a light one, upon persons who already pay the indirect *octroi* duties. I consider, nevertheless, the disappearance of the personal tax in the larger cities of France as something to be regretted. Believing in the maxim that every one should pay a direct tax, I should prefer that the personal tax, and even the *mobilier*, should continue in the large cities; and that some of

[1] Translated from his Traité des finances, Pt. I, Bk. II, ch. 5.

[2] An apportioned tax is one that is not assessed directly upon individuals at established rates; but is first apportioned among the smaller civil divisions, the quota due from each division being finally assessed upon individuals. — Ed.

[3] Duties levied upon liquors, provisions, and sometimes other articles, upon their entry into towns. — Ed.

the *octrois*, particularly those on indispensable articles of food, should be reduced or abolished.

The second peculiarity is that, by the law of 1832, the personal tax is not subject to sur-taxes[1] for any purpose, whether national, departmental, or communal. The personal tax, therefore, not being subject to sur-taxes, varies from the minimum rate of one franc fifty centimes to the maximum rate of four francs fifty centimes, according to the commune. If it were really intended to make it equal to the value of three days' labor, the rate should range at least from four and one half to nine francs; for there is no part of France where a day's wage is less than one franc fifty centimes, while in large cities and prosperous agricultural or industrial districts it never falls below three francs. Naturally enough the yield of the personal tax in France is very small, because the valuations of a day's labor are so low. But the number of persons subject to the tax has steadily increased. . . .

. The number of persons paying the personal tax, including those whose contribution is defrayed out of *octroi* duties, was not less than 7,799,000 in 1866. To-day, despite the loss of Alsace and Lorraine, it has reached the figure of 8,000,000. If the valuations placed upon a day's labor were raised to the correct figures, — one and one half francs for the poorer districts and three francs for the cities and the richer districts, — the assessment would be 5.25 francs per contributor, even if the average day's wage were placed as low as 1.75 francs. This rate for 8,000,000 of contributors would bring in 42,000,000 francs, or about 26,000,000 francs more than the present yield. This simplification in our finances would permit us to abolish certain objectionable indirect taxes, like that on salt, the product of which is 30,000,000 francs. This would be a very desirable result. . . .

Far from rejecting all capitation taxes, I believe that a moderate tax like that just described would have an excellent effect. It would dispense with indirect taxes upon such a necessity as salt; would make the people feel that the payment of a tax is a

[1] In France departmental and local expenses are met largely out of sur-taxes (*centimes additionnels*) added to the rates collected for national purposes. Sometimes a sur-tax is levied for national purposes. — Ed.

necessary accompaniment of the enjoyment of civil rights; and would teach them that the government can collect directly from the laboring classes at least a part of their share in the expenses of the state.

52. The Working of the Impôt Mobilier. — Although intended to be a proportional tax upon the rental value of dwellings, the *mobilier*, in its actual operations, is something different from what the law contemplates. Boucard and Jèze give the following account of the working of the tax:[1]

The *mobilier*, in law and in practice, is tending to become a progressive tax.

This tendency in practice is the result of changes prescribed by custom. In order to understand this custom, it is necessary first of all to notice that the *mobilier* is joined to the personal tax, and that the combined tax (*personnel-mobilier*) is apportioned.[2] In other words the amount to be raised for national purposes is fixed each year by the law regulating the finances (*la loi de finances*), and is divided among the departments by the same law.[3] The quota of each department will be divided among the *arrondissements* by the general councils; and the quota of each *arrondissement* will be divided among the communes by the council of the *arrondissement*. Then the quota of each commune will be assessed upon the taxpayers by officials

[1] M. Boucard and G. Jèze, Cours élémentaire de science des finances, 347 *et seq.* (third edition, 1903).

[2] The authors explain, as Leroy-Beaulieu does, the method of keeping the rate of the personal tax fixed while apportioning the *mobilier*. They then give this illustration:

"Suppose that the quota of a commune is 1000 francs. Suppose, too, that the total assessment of the personal tax (that is, the value of three days' labor for all taxpayers) is 300 francs. The difference, or 700 francs, will be assessed *pro rata* upon rentals by the provisions of the *mobilier*." — Ed.

[3] Naturally enough, the result of apportioning the tax has been to produce shocking inequalities between departments, *arrondissements*, and communes. . . . The equalization of the apportionment constitutes a serious problem. (The authors go on to show that in some communes the quota to be raised is as low as 2 per cent of the rental value of all dwellings, and that in others it rises to such a figure as 10 per cent or more. In 1901 a law was passed to alleviate the situation, but it does not meet the needs of the case.)

appointed by the prefect from a list presented by the municipal council. In this work the officials do not follow the law, which prescribes *pro rata* assessment of rental values. In 1884 it was ascertained that in 2340 communes, representing 1,733,000 contributors and 24,305,000 francs of the principal of the tax, the *mobilier* was based upon rental values, in accordance with the law. In 1657 communes, representing 238,000 taxpayers and 732,000 francs of the tax, the assessment was based upon rental value, but without precise rules and without always following the rule of proportionality. In 18,664 communes, representing 2,684,000 taxpayers and 8,351,000 francs of the tax, the officials assessed the tax according to the rental value *and the supposed ability of the taxpayers*. Finally, in 13,446 communes, representing 1,981,000 taxpayers and a tax of 6,280,000 francs, the assessment was based upon the supposed ability of the taxpayers as estimated by various *indicia* such as the area of cultivated land, the amount of live stock owned, the number of teams of horses, or such other indications as accorded with the conditions of the regions and the habits of the people. Thus there were only 3997 communes out of 36,107 which conformed to the requirements of the law; and in over 32,000 communes the assessment was according to the discretion of the officials. In the same locality one could find some of the rentals taxed at double the rate imposed on others. The conditions have not changed since 1884. It is known that in most of the rural communes, where the dwellings are much the same whatever the wealth of the occupants may be, the assessors, struck by the fact that often two taxpayers of very unequal ability are housed in about the same manner, have made the tax progressive by increasing the assessed valuation.

The progressive character of the tax has also been sanctioned by the law, through exemption of a certain minimum rental. (Then follows an account of certain provisions of laws enacted in 1846, 1900, and 1903, which sanction in certain cases a departure from a proportional rate of taxation.[1])

[1] One other fact concerning the practical working of the tax is emphasized by Leroy-Beaulieu. When the quota of the *personnel-mobilier* due from a commune is apportioned among the taxpayers, it is clear that, the lower the value placed upon a day's labor, the smaller the amount raised by the personal tax, and the larger the

53. The Theory of the Impôt Mobilier.—Interesting to American readers, on account of various proposals which have been made in the United States, is Leroy-Beaulieu's discussion of the merits of the *impôt mobilier.* He says: [1]

When the legislator abandons the idea of taxing directly the entire income of the taxpayers because he does not wish to resort to arbitrary official assessments and apprehends the deceptions which result from calling for personal declarations of one's income, the best method of taxing citizens according to their abilities is to impose a tax upon the rental value of dwellings. The house rent that a man pays is the least deceptive index of the size of his property or income. Among people who love material comforts and luxuries the first use generally made of wealth is to enlarge and to embellish one's dwelling.

The opponents of this tax (the *mobilier*), who are usually advocates of a general tax on property or income, find many objections to it. Certain persons, they say, by their natural tastes, for reasons of family convenience, or by professional necessity, expend for house rent a larger portion of their income than is ordinarily devoted to that purpose; while others, on account of simpler tastes, or for economy's sake, spend but a small part of their income for rent. The first class will be overtaxed, and the second undertaxed, by the *mobilier.* This objection is specious. It proves that the tax on rentals is not perfect; and persons who are sanguine of attaining absolute perfection in fiscal affairs, can reject this tax as not realizing their ideals. But though specious, the objection is not well founded. In the first place, the law can permit a taxpayer to furnish proof that the income which his lodgings indicate that he has is larger than his real income. There would be nothing unjust in demanding that a person in an unusual situation should demonstrate the fact. As for the demands which a profession, like that of the doctor or lawyer, make upon one's income, it would be possible to take this element into account in assessing

amount to be raised by the *mobilier*, will have to be. Since the valuations of a day's labor range from 50 centimes to 1.50 francs, it is clear that the rate of the *mobilier* must vary considerably.—ED.

[1] Traité, Pt. I, Bk. II, ch. 7.

the tax. In this way the tax could be reduced for taxpayers whose profession obliges them to occupy dwellings that are more expensive than those occupied by most persons having the same income. Yet these deductions and allowances do not seem very necessary since the rate of the tax ought always to be moderate.

It is probable that after a time, and just because of the tax, every one will spend for rent just about the proportion of his income which the law assumes that he spends. Few people would care, through ostentation or negligence, to place themselves in a position where they would have to pay a disproportionate tax. As for misers who wish to cheat the government by occupying lodgings far less expensive than they could afford, it is evident that it is difficult to prevent them from doing so in any case. . . .

An objection of greater weight is that the tax on rentals burdens large families more heavily than small; whereas the former should rather be favored than burdened by the tax-gatherer. We may observe that this objection is equally valid against taxes upon consumption, although not against a general tax on property or income. . . . But the difficulty is easily avoided. It would be removed if, in the assessment of the tax, allowance was made for the size of families. A bachelor could be taxed at a higher rate than a man with a family; and, further, the tax could be reduced in rate according to the number of children in a family. Thus, supposing that the rate of the tax were 12 per cent of the rent paid by a bachelor, it could be reduced to 10 per cent for a married man; and might be lowered by one per cent for each child living with its parents; so that a family with four children would pay but 6 per cent of the amount of rental, while a bachelor would pay 12 per cent. (The author then argues that the *mobilier* taxes funded incomes more heavily than unfunded, since, income for income, persons who draw revenue from property will spend more for rent than persons with temporary incomes.)

To this tax on rentals could be added, as the Constituent Assembly did in 1791, certain simple sumptuary taxes, such as taxes on pleasure carriages and servants. We shall discuss such sumptuary taxes later. Here we may say that if they are added to the *mobilier*, the rate should increase according to the

number of carriages or servants. The tax, for example, should increase 10 per cent if the taxpayer keeps horses and carriages, and should increase 5 per cent for each male servant.

* * * * * * *

The preceding discussion has shown that the tax on rentals, which is called improperly the *mobilier*, is one of the best that exists. It certainly is not perfect;[1] but it can be made proportional to the income, or, rather, the ability, of the citizens as closely as is possible in fiscal affairs. It avoids arbitrary methods. And finally it can be made very productive. The rental value of all buildings in France may be estimated at not less than 2,000,000,000 francs. From this we must make some deductions in order to obtain the rental value of dwelling houses; shops, factories, and stores should, therefore, be left out of the estimate. The rental value of dwellings cannot be less than 1,800,000,000 francs. An average tax of 10 per cent, for state and local purposes, would yield 180,000,000 francs; whereas the present *mobilier*, with the personal tax included, yielded only 164,000,000 in 1896.

54. Proposals for a Tax on Rentals in the United States. — The New York Tax Commission, in 1871, proposed that the state should levy a tax on rentals, as a substitute for the existing tax on personal property; and similar recommendations have come occasionally from other sources. As lately as 1897 the Massachusetts Tax Commission, after recommending that the present taxes on intangible personalty be abandoned, proposed that a tax on direct inheritances and a tax on "the occupants of habitations" should be introduced as substitutes. In defense of the suggested tax on rentals, the commission said:[2]

We have said, when discussing the possibility of an income tax, that some contribution in proportion to income enjoyed

[1] Elsewhere the author says: "The great fault of the *mobilier* is that it is an apportioned tax. The quota demanded from each political division is based upon old assessments, and the product of the tax does not keep pace with the increase of wealth. . . . The only way to reform it is to change it into a rated tax." — ED.

[2] Report, pp. 104–109.

would be a desirable addition to the tax system of the commonwealth. In addition to the tax on inheritances and successions, something more in the way of immediate and direct contributions from present incomes seems to us desirable, both as a supplement to the inheritance tax and as an addition to the financial resources available for public expenditures.

For this end we recommend for adoption by the General Court a tax on presumed or estimated income, based on the expenditure of the taxpayer for dwelling-house purposes. We propose that a tax shall be levied on all persons occupying dwellings of an annual rental value of more than $400, at the rate of 10 per cent on the excess of rental value over that sum. We propose to levy no tax of this sort on persons whose incomes are so moderate that their expenditure for dwelling accommodation is not over $400 a year. Those whose income is such that they exceed this expenditure for their dwellings, are to pay, not in proportion to their total dwelling rental, but in proportion to the excess of rental over the exempted limit of $400. Thus, a person occupying a house whose rental value was $500 would pay a tax of $10 a year, this being 10 per cent on the excess of the rental value over $400. A person occupying a house whose rental value was $600 would pay a tax of $20; a house of $800 rental, $40; a house of $1200 rental, $80; and so on. The tax, it will be observed, is on the occupier of a dwelling, and of a dwelling only. Houses or parts of houses used for business purposes are in no way affected by it. The tax is to be levied on the occupier, whether he be owner or tenant. If owner, it is a tax on his general income, additional to the direct tax which he pays as owner of the house. If tenant, it is again a tax on his general income, separate from the direct tax which the landlord pays on the house. In either case, it is a tax on presumed or estimated income, proportioned (in the manner described) to the expenditure for dwelling accommodation.

In the bill which we submit for this tax, we have endeavored to make appropriate provision for the difficult cases which would need to be considered in its administration: for apartment houses, where the separate apartments or tenements may be above or below the exempted amount; for buildings occupied partly for trade and partly as dwellings; for boarding and

lodging houses; and so on. As to the specific legislation which seems to us best for these details, we refer to the several clauses of the bill. We wish here to bring to the attention of the General Court the advantages of such a tax, which seem to us to outweigh its disadvantages, undeniable though the disadvantages be.

It may be contended that such a tax is unequal in its operation. It bears more heavily on a man of large family than on one of small family, since the former will probably spend a larger proportion of his income on dwelling accommodation. It may not reach at all a bachelor, perhaps of good income, yet not called on to spend much of it for his lodgings. In general, expenditure for dwellings is only a rough and uncertain test of income. Two men of the same income may occupy very different sorts of houses; while, on the other hand, a rich man and a man of moderate means may occupy houses of the same general character. As a man grows richer, while he will probably spend more for his dwelling, it is very possible that he will not spend a sum larger in proportion to his increased means.

These disadvantages are real. As compared with an ideally arranged and ideally administered income tax, this form of tax is not to be commended. But no perfect income tax, indeed, no perfect tax of any sort, is within reach; and we must compare any proposed tax, not with the best that could be got under ideal conditions, but with the best that is practically available. Every system of taxation brings occasional hardship and inequality. The essential question is whether a given method of taxation secures on the whole substantial justice, can be administered smoothly, and will yield a large and regular revenue. A tax, moreover, must be considered not by itself alone, but in connection with the nature and effects of other taxes imposed side by side with it. The proposed tax, in combination with the other changes we recommend,[1] seems to us not only to be greatly better than what we now have, but to promise better results than any other available method.

[1] The other changes recommended were as follows:

"1. An inheritance tax, levied with respect to realty as well as to personalty, at the rate of 5 per cent, with an exemption for estates not exceeding $10,000 and an abatement of $5000 on estates between $10,000 and $25,000. The revenue from

The tax begins at a very moderate rate (being levied only on excess of rental over $400), and it becomes heavier as the scale of dwelling accommodation rises. It may be true that for the very rich the scale of tax does not rise in proportion to the total income. But, on the other hand, the inheritance tax, as proposed by us, bears with its full weight on the rich, while it is subject to exemption and abatement for those of small or moderate means. We have recommended, under the inheritance tax, exemptions of estates of $10,000 and less, and abatements on estates up to $25,000, while estates exceeding $25,000 pay tax on their full value. Each of these taxes, the inheritance tax and the house-rentals tax, tends to supplement the other.

The advantages of a tax on house rentals can be easily stated. It is clear, almost impossible of evasion, easy of administration, well fitted to yield a revenue for local uses, and certain to yield such a revenue. It is clear, because the rental value of a house is comparatively easy to ascertain. The tax is based on a part of a man's affairs which he publishes to all the world. It requires no inquisition and no inquiry into private matters; it uses simply the evidence of a man's means which he already offers. We have provided that a taxpayer may either declare the value of the dwelling he occupies or leave it to be estimated by assessors; the matter being one which, in the majority of cases, can be so nearly estimated without declaration by the taxpayer that it is not very material whether he hands in a statement or does not. It cannot be evaded except by change in the style of living, which few people, if any, would undertake because of a moderate tax. We have endeavored to provide, in the bill submitted, for the due assessment of persons dwelling in apartment houses and in hotels. We have provided also for the payment

this tax to be distributed from the state treasury among the several cities and towns, one half in proportion to population, one half in proportion to assessed valuation.

"2. A tax on occupiers in proportion to house rentals, only the excess over $400 of rental being taxable.

"3. Abolition of the present taxes on intangible personalty, such as stocks, bonds, loans on mortgage, income; the taxes recommended under 1 and 2 being relied on to yield at least as large a revenue as is now secured by the taxes to be abolished.

"4. Assumption by the state treasury of county expenses.

"5. Appropriation by the state of the revenue from taxes on corporate excess, now distributed among the several cities and towns." Report, p. 120. — ED.

of two taxes in respect of house rentals by those persons who are so well-to-do as to occupy for their own use two separate houses in the commonwealth; for the bill provides that (except in case of mere change of residence) occupancy of any dwelling for a period of three months or more shall be ground for the collection of the tax. Hence those who have winter and summer houses will pay this tax in both localities in which they reside.

It may be objected that the tax is on real estate, and is additional to the taxes already levied on real estate. As to the owner of a dwelling who occupies it for his own use, it is true that he will pay not only the present taxes on the real estate, but another tax based on the rental value of his house. But this additional tax is levied with respect to the income which he must have, if able to live in an expensive house. No one can own and occupy a house whose rental value is $600 or $800 or $1000 a year, unless he has some considerable income from other sources; and on that income he may be fairly called on to pay a tax, if it be not unduly heavy, and be proportioned in some approximate way to his income. So far as tenants of dwellings are concerned, the owners are called on to pay the direct tax on the real estate, and the tenants alone to pay the proposed tax on rental values. If, indeed, this second tax were so heavy as to cause tenants to avoid dwellings whose occupancy would subject them to it, and were to cause them to seek cheaper houses, it might indirectly affect the demand for houses, and so might affect their rentals. But the rate of tax, as proposed, is very low on houses of moderate rentals, and advances slowly on houses of higher price. We do not believe it would cause any appreciable shifting in the selection or tenancy of dwellings, for comfort or luxury in dwellings is highly valued by most men, and they will hardly modify their expenditure on it because of a moderate tax. We believe, therefore, that this tax would operate, as it is designed to operate, not as a tax on real estate, but as a tax on the incomes of those who are prosperous enough to dwell in comfort or in luxury. We may remark, also, that its financial yield would be an important addition to the revenue of the towns and cities in which it would be levied, and would operate, so far as this went, to make possible a reduction in the rate of direct taxation on real estate.

This brings us to the financial aspects of the proposed tax, in which we find additional strong reasons for its adoption. It is obvious that it would be collected chiefly in the cities, in certain of the larger and more prosperous towns, and in some of the smaller towns whose climate and site cause them to be resorted to by persons of means. The agricultural towns would be almost wholly outside its scope. The strictly manufacturing cities and towns would be little affected. In the other cities, and in the towns affected by it, the tax would be collected solely from those able to live in comfort and luxury, and would be of considerable weight only on the well-to-do. In these places, also, it would be of financial importance. These are precisely the parts of the state which would lose financially from the re-adjustments proposed by us in connection with the inheritance tax. As we have already pointed out, these places would gain less from the distribution of the proceeds of the inheritance tax than they would lose by giving up the revenue now derived from the taxation of intangible personal property. This difference would be more than made up, in most places, by the new revenue from the house-rentals tax.

The revenue from this tax must be almost entirely a matter of estimate. There is hardly any basis on which to make any specific statement in figures. But we have made a rough calculation as to one ward in Boston, that containing the Back Bay district, and we think it well within bounds to put the tax revenue in this single ward at about $300,000. For the whole city of Boston we think $500,000 a low estimate of the proceeds. The financial loss of Boston from the rearrangements we have proposed elsewhere would be fully made up by this sum. Newton and the town of Brookline would secure a large revenue; the same would be the case in cities like Cambridge, Worcester, Springfield. Similarly, the summer resort towns, whose present gains from the taxes on intangible personalty would cease on the adoption of our proposals, would find some compensation in the revenue from the new tax. The introduction of this tax, in fact, would prevent any financial shock from the other important changes which have been proposed, and would enable the commonwealth to enter at once, without any painful process of readjustment, on a new, and, as we believe, a better system of taxation.

In view of the imposition of this new tax based on presumable income, we recommend the abolition of the present tax on incomes "from profession, trade, or employment." We make this recommendation, not only because the retention of the existing tax side by side with that proposed must result in double taxation of the same object, but because the present tax has proved no less difficult of satisfactory administration than the other parts of the present method of taxing intangible personalty. As matters stand, the partial income tax which the statute imposes is assessed and collected in the most uncertain and unequal manner. Some persons in receipt of salaries that are well known are taxed unfailingly on such income, and this is especially the case with public officers, whose salaries (usually very moderate) are published in official documents. Many other persons, in receipt of larger salaries from corporations or from private employers, never hear of the income tax. Physicians and lawyers who earn incomes from their professions are taxed by guesswork, often not at all, very rarely with certainty and accuracy. The same is true of business men; except that here, in the cases where the income tax is assessed and collected, it is additional to the taxes on the real estate, machinery, and stock in trade of the business carried on, and so is open, in part if not in whole, to the charge of double taxation. In fact, the difficulties which we have referred to elsewhere, when discussing the proposal for a general income tax, have appeared in full evidence with the existing income tax. On every ground, therefore, and especially in view of the proposed tax on house rentals, we recommend its abolition.

CHAPTER XIV

TAXES ON BUSINESS

55. The French Business Tax. — Established in 1791 and receiving practically its present form in 1844, the French business tax (*impôt des patentes*) is one of the oldest taxes on business profits, and has served as a model for business taxes in many other countries. The following description of this tax is taken from a recent treatise:[1]

The tax is defined by the law of 1880, as follows: "Every person, Frenchman or foreigner, who carries on in France any trade, industry, or profession, not expressly exempted by the law, shall be subject to the business tax."

The tax, then, is general. The law aims to reach all profits from industry or profession without any exceptions other than those expressly granted. The omission of any occupation from the published tariff of charges is no reason for exemption; in this case, an administrative ruling is made in order to reach a taxpayer who would otherwise escape. . . .

The *impôt des patentes* is composed of a "fixed" and a "proportional" duty. The purpose of the law in providing a proportional as well as a fixed duty was, on the one hand, to make a proper distinction between various occupations, and, upon the other, to proportion the tax to the profits realized by persons engaged in the same occupations. The fixed duty, therefore, seems to be a tax on the occupation, independently of the conditions under which it is carried on; while the proportional duty is designed to take account of these conditions.

[1] J. Caillaux, Les impôts en France, I, 46 *et seq.* (Paris, 1904).

The Fixed Duty

The occupations subject to the fixed duty are described in three schedules, A, B, and C, which are appended to the law.

(1) Schedule A includes the general run of merchants and artisans. Merchants can be divided into three classes: those who sell principally to other merchants (*marchands en gros*), those who sell both to retailers and to consumers (*marchands en demi-gros*), and those who ordinarily sell only to consumers (*marchands en detail*).

In this schedule the fixed duty is based upon the nature of the occupation and the population of the locality. The occupations are divided into eight classes, for each of which nine rates of duty are prescribed according to population. For example, in order to ascertain the fixed duty to be paid by a grocer in the city of Toulouse, it is necessary first to determine in what class his occupation belongs. He will be in the first class if he is a wholesale grocer; in the second class, if he sells both to retailers and consumers; and in the fifth class, if he is a retail dealer. Then, in the second place, it will be necessary to examine the rates of duty applying to the class in which the grocer belongs, and to select the one which corresponds to the population of Toulouse.

(2) Schedule B applies to a certain number of occupations, such as bankers, proprietors of department stores, and water or omnibus companies. It was thought that the population of the locality was not the only element to be considered in graduating the rates for different persons in any one of these occupations; and also that the occupations themselves could not be classified, as are those in Schedule A. Therefore a special charge was established for each of these occupations; and an attempt was made to adjust the fixed duty according to profits, by breaking it into two parts in the majority of cases. The first part is a determinate charge (*taxe determinée*) which varies for the same occupation according to the population of the locality and, in exceptional cases, according to other circumstances. The second part is a charge based upon the number of persons employed in excess of five, and applies to most of the occupations in the schedule. In some cases, however, such as water, omnibus, and

hack companies, there is no tax upon employees, but simply a special set of charges for these occupations. (The author then describes an amendment of 1893 relating to department stores. This amendment imposed rates which increase progressively according to the number of employees and the population of the city.)

(3) Schedule C applies to industrial pursuits. It takes no account of the population of the locality where an establishment is situated, since this generally has little to do with the importance of the enterprise. Here the fixed duty may be simply a determinate charge, a charge composed of variable elements, or a combination of the two.

The determinate charge is uniform for all taxpayers in the same occupation. It is, for instance, five francs for all tile makers whatever the conditions may be under which they carry on their industry.

The variable charge is intended to take account of the importance of the establishment and to proportion the tax to the size of the plant. The law selects in such occupations whatever appears to be the best index of the probable profits. Thus a brewery is taxed according to the capacity of its boilers; a hat maker, according to the workmen he employs; a chocolate manufacturer, according to the number of workmen and machines in his factory. . . .

The Proportional Duty

The proportional duty is based on the rental value of both the dwelling house of the taxpayer and the premises used in the profession or industry. The rate of this duty is not uniform, and is regulated by the provisions of a fourth schedule, Schedule D. For persons included in Schedule A the rate of the proportional duty varies from 2 to 5 per cent of the rental value; in Schedule B it is 10 per cent, with a few exceptions; in Schedule C it ranges from $1\frac{2}{3}$ per cent to 10 per cent. Often the rental of a taxpayer's dwelling is taxed at a different rate than the rental of the premises occupied by his business establishment. The so-called "liberal" professions, such as those of the lawyer, doctor, and the like, pay only the proportional duty in Schedule D, and are exempt from the fixed duties.

The rate of the proportional duty is generally $6\frac{2}{3}$ per cent of the rental value, but in exceptional cases it rises to $8\frac{1}{3}$ per cent.

This general scheme is sufficiently complex; but in its practical application further complexities appear. Thus a person who carries on two or more branches of industry in separate establishments, pays a separate fixed duty upon each establishment. If, however, he carries on two or more occupations in the same establishment, some reduction is made, the mode of computation being peculiarly complex. Similar intricate adjustments are prescribed for the proportional duty under the circumstances just described. Partnerships and corporations give rise to further complexities. The senior member of a partnership pays the entire fixed duty; while, in addition, the junior partners pay a fractional part of the duty proportioned to the number of members in the firm. The proportional duty is paid upon the residence of the senior partner and all the buildings occupied by the firm, but the dwellings of the junior members are exempt.[1] Corporations pay merely the fixed duty for every establishment they own. There is also a complicated system of exemptions.[2]

Unlike most parts of the French direct-tax system, the *impôt des patentes* is a rated, not an apportioned, tax. In 1901 its total yield was 211,000,000 francs, an increase of 46,000,000 francs in twenty years. Of this sum 134,000,000 francs was raised for the national government, and 77,000,000 for the departments and communes. The relative importance of the four schedules is shown by the following figures which give

[1] The result is heavier taxation of partnerships. Leroy-Beaulieu says that a manufacturer with 1000 employees in a certain branch of business would pay a tax of 10,266 francs if he carried on the business on his own account; whereas if he had two partners, the tax would rise to 15,336 francs.

[2] Government employees, artists, and teachers are exempt; also farmers, whose profits are supposed to be reached by the land tax.

the amount collected, under each schedule, of the principal[1] of the tax in 1902:

Schedule A	55,473,000 francs.
Schedule B	10,117,000 francs.
Schedule C	19,961,000 francs.
Schedule D	3,908,000 francs.

Thus the bulk of the tax is collected from the merchants and shopkeepers, large and small, who are included in Schedule A.[2]

The theory upon which the *impôt des patentes* is constructed is the same as that which underlies the *impôt personnel-mobilier*. Concerning it, Leroy-Beaulieu says:[3]

In taxing the profits of industry and commerce we have but three methods of procedure: (1) the government can undertake inquisitorial inspections of books and documents of the taxpayers; (2) the taxpayers may be required to declare their profits, under oath; and (3) we can use external signs, indicia more or less vague, which allow us to value approximately, not the profits of any particular establishment, but those of each category of merchants.

Each method has grave faults. In France, a somewhat unstable democracy where every one is afraid of arousing public envy, the people are very unwilling to allow tax officials to become conversant with their personal affairs. It is feared that, if the officials take a single step across the threshold, they will soon wish to take ten; and it seems preferable to keep them outside the house rather than to contend later to fix a limit to official intervention and control. The maxim "*principiis obsta*" is universally approved in this matter.

The second method, that of taxpayers' declarations, may be criticised on different grounds. No society is composed wholly of men who are invariably honest; and, when declarations are employed, there are too many temptations to fraud. Doubtless

[1] The principal of the tax is subject to additions both for national and local purposes. These additions, made on a percentage basis, bring the total yield up to the figures given above.

[2] Of the eight classes of taxpayers in this schedule, the fourth, fifth, and sixth, representing establishments of moderate size, pay over three fifths of the tax.

[3] Traité de la science des finances, Pt. I, Bk. II, ch. 8.

this evil can be reduced by vigorous administrative control and shrewd inquiry by the tax officials; but then we fall back into the evils of the previous method. Even admitting, what one must be very skeptical to deny, that dishonesty is the exception, nevertheless the use of declarations has the fault of subjecting the most honest men to the suspicion of bad faith and evasion.

We do not say that these inconveniences of the two methods just discussed are not offset by numerous advantages; but the people of France have been less impressed by the advantages than the disadvantages of these methods. It is necessary, therefore, in this state of popular opinion, to adhere to a system of taxation according to legal presumption, to certain external indicia, which put the taxgatherers on the track, not of the profits actually realized by the taxpayer, but the possible or probable profits. This system is, by its very nature, defective; it can be improved, but can never be perfect. One of its chief defects is that it can throw no light upon the profits of each individual trader; its basis is, in fact, the assumed average profit which each class of traders can reasonably make under given conditions of business. Thus, in this system, cases of injustice to individual taxpayers will always be numerous; and every project for improvement will confine itself to providing that no branch of industry shall be favored at the expense of another.

From 1791 to the present day there has been a constant effort to make the *impôt des patentes* more nearly proportioned to the profits of the taxpayer. The more just our legislation has tried to be, the more complicated it has become. It is by making new distinctions, adopting new and more numerous indicia, that the law has succeeded in eliminating some of the crying injustices in the assessment of the business tax.

* * * * * * *

This tax is assessed in France according to the four principles that follow:

1. Profits are not the same for all industries. There are various industrial and commercial pursuits which, on their very face, differ greatly from one another in respect of their probable profits. Thus, it is fair to presume that a banker makes larger profits than a joiner, and that a grocer makes more than a cobbler. This is a presumption which is reasonable and justifies the

classification of industries according to their assumed importance.

2. For commercial enterprises of the same class the profits ordinarily are in some proportion to population of the locality where the trade is carried on. A grocer in Rouen has a better chance to make money than one in Yvetot; and the latter has a better chance than a grocer in a small village. This presumption, too, is not unreasonable so far as retail trade is concerned; but it is totally invalid in the case of manufacturing establishments. Therefore the law does not employ it in the latter case.

3. The profits of a manufacturer or merchant maintain usually a certain proportion to the size of the premises occupied, the number of machines used, and the number of employees. Thus a spinner operating a factory with one hundred thousand spindles has a prospect of larger profits than a competitor with an establishment having ten thousand spindles. A grocer with large stores can be presumed to have a better chance to make money than one who occupies a small store. A dealer in notions who has one hundred employees has a better chance than one who employs but ten persons. This presumption is not unreasonable; it is almost the only one applicable to large industries.

4. Business profits often stand in a certain relation to the dwelling that a person occupies; since the larger they are, the better the house that the recipient will occupy. This presumption, while not false, is the least accurate of the four. A man's dwelling may be an indication, rather, of the fortune he has previously acquired, of his personal tastes, or of the size of his family. Then, too, it can be said that, since a business man has already paid the *mobilier*, it is clearly unjust to tax him again upon his dwelling.

However the matter may stand, these four presumptions give rise to an extremely complicated system of taxes which are often faulty in particular cases; but, nevertheless, the best that can be invented if it is proposed to tax the business profits without resorting to declarations of the taxpayer or inquisitorial investigations by the taxgatherers. It is necessary, besides, never to lose sight of the fact, already mentioned, that the business tax does not attempt to tax profits actually realized so

much as the profits that can be reasonably expected under the given conditions. If these average, or probable, profits are not actually realized by the taxpayer, the treasury does not reduce its demands; if, on the other hand, they are exceeded, the demands of the treasury do not increase.

56. The Prussian Business Tax. — Prior to reforms effected in 1891 the Prussian business tax (*Gewerbesteuer*) was modeled more or less after the French tax. Industries were divided into eleven classes, and the rate of the tax was graduated according to the size of the city or locality in which the business was carried on. The Prussian tax differed from the French model, however, in important particulars. In the first place, instead of fixing a hard and fast rate for each class of industries, the law levied an average rate upon all establishments of the same class located in the same locality, thereby leaving much to the discretion of the assessors. This average rate multiplied by the number of business enterprises gave the total amount to be collected from the persons in any given trade or occupation in any locality. Then for the purpose of dividing this quota among the different establishments to be assessed in each locality the law provided that the taxpayers of each industry should elect assessors from their own numbers. Such assessors, presumably, would be acquainted with the general condition of each taxpayer's business, and would be able to effect a just distribution of the tax, within the restrictions imposed by the law.[1]

In 1891, however, the Prussian tax was radically changed in many of its principal features, thereby losing all resemblance to the French business tax. These changes have been described by Dr. J. A. Hill, as follows:[2]

[1] The law provided, for instance, that no one should pay less than half the average rate for the class. This prevented disproportionate assessment of the large establishments.

[2] *Quarterly Journal of Economics*, Vol. VIII, 82–92. Reprinted with consent of the author.

Such were the main features of the Prussian business tax previous to 1891. The law of that year introduced important changes. The old classification of industries has been abandoned, and the population of the place in which the business is located is now no longer taken into account in regulating the tax.

The basis of the new classification is for all kinds of business alike, either the annual earnings or the capital. There are four classes (*cf. Gesetz von Juni* 24, 1891, § 6): the first includes business or industrial undertakings which either yield annual earnings amounting to not less than 50,000 marks, or employ a capital (fixed and circulating) of not less than 1,000,000 marks; in the second class may be rated those businesses with annual earnings from 20,000 to 50,000 marks, or with a capital from 150,000 to 1,000,000 marks; in the third, those with earnings from 4000 to 20,000 marks, or with capital from 30,000 to 150,000 marks; and in the fourth, those with earnings from 1500 to 4000 marks, or with capital from 3000 to 30,000 marks. Any business in which neither the earnings amount to 1500 marks nor the capital to 3000 marks is exempt from the tax (*Gesetz*, § 7). It was estimated that this limit would exempt about 300,000 small business undertakings, or more than one third of the total number of businesses (865,940) assessed under the old law (*cf. Einleitung des Gesetzes*).

This double basis of classification may at first seem somewhat confusing, or even inconsistent with the plain rule of logic that a division must be founded on one principle or basis. But a further study of the law shows how the two bases are to be employed so as to avoid difficulty. Each business is classified on the basis of either its earnings or its capital. When it belongs in one class on the first basis and in another on the second, the tax officials have, with certain exceptions which we shall mention presently, practically the option of rating it in either class. Of course, having regard to fiscal considerations only, it would be natural to rate the business in the higher class, where it would yield considerably more to the public revenues than in the lower. Accordingly, the intention is that in general earnings shall be employed as the principal basis of classification; but it is deemed practically advantageous to use capital as a secondary or alternative basis, because

there are cases in which it is especially difficult to estimate the earnings, — as when a business is newly established or where it is carried on principally in foreign countries, although having its location or some one factory in Prussia. Furthermore, it is urged that this use of two bases meets with favor in business circles, where occasions for dissatisfaction would often arise if a business were transferred to a lower class or perhaps exempted from the tax altogether, simply because, owing to some special combination of circumstances (*Konjunctur*) or to some single error of management, its earnings had temporarily fallen below the limit of the class in which it had hitherto been rated (*Einleitung des Gesetzes*).

But, whichever basis of classification may be employed, the tax for each class, as we shall see, is graded with reference to the estimated earnings. It is apparently meant to be a tax on profits rather than capital. Therefore, if a business is correctly classified on the earnings basis, the fact that it may belong in a lower class on the basis of capital does not show that the tax on it is disproportionately high. That fact simply means that the business derives, relatively, large earnings from small capital, or, in other words, is unusually profitable, and may be taxed accordingly. The law allows no appeal from the classification in such cases as this.

The case is otherwise when the business is correctly classified on the basis of capital, but on the basis of earnings belongs in a lower class. Here the tax may prove to be higher in proportion to the earnings than was intended; and the law has taken such cases into consideration by providing that any business, even when correctly classified on the basis of capital, must be transferred to the next lower class on proof that for two years in succession the earnings have not amounted to 30,000 marks in Class I, 15,000 marks in Class II, or 3000 in Class III (*Gesetz* § 8). These amounts, then, represent the minimum limit of permanent earnings for these three classes respectively. Whatever the capital may be, the business cannot be retained in the class in question unless the earnings come up to this limit. The limit, it will be observed, is considerably below that which is adopted for the classification on the earnings basis. On that basis no business can be classified in

Class I, for instance, unless its earnings amount to 50,000 marks. If, however, its capital amounts to 1,000,000 marks, it may be classified on the basis of capital, and retained in Class I so long as its earnings amount to 30,000 marks. It does not follow, however, that, because under these conditions the business is retained in Class I, it must pay as high a tax as it would if its earnings were sufficient to rate it in that class, or that it must pay a higher tax than it would if, on the basis of earnings, it were transferred to Class II. This will be apparent when we come to consider the scale of rates.

There are no provisions corresponding to the above in case of Class IV, the lowest class. Therefore, no business with a capital of 3000 marks is exempt from the tax, however small its earnings may be; but under the scale of rates in that class the tax may readily be adjusted to cases in which the earnings are unusually low in proportion to the capital.

In determining what constitutes earnings or capital, the tax officials have to rely mainly on their own personal knowledge and judgment. But a few general principles are laid down in the law. The costs of the business are to be deducted from the gross receipts, and a proper allowance made for depreciation or loss in value (*Werthverminderung*),[1] and for the loss incurred by discarding machinery or other equipments of the business. But the interest on capital, whether borrowed or not, and on debts cannot be deducted. Neither can expenditures for the improvement or extension of the business, nor for the living expenses of the owner and those dependent on him. Fixed and circulating capital is briefly defined as comprising all the value permanently devoted to the prosecution of the business (*Gesetz*, §§ 22, 23).

The method of assessing the tax by means of a medium or average rate has, as we have said, been retained in the new law: it does not, however, apply to Class I. There its adoption was considered impracticable, owing to the wide differences in the earnings and capital of businesses rated in this class. Therefore, each business is assessed separately and independently.

[1] This, it seems, includes loss occasioned by wear and tear (*Abnutzung*) of the buildings and equipments and any depreciation in the value of wares or of the outstanding claims of the business, etc.

The tax is graded so as to collect approximately 1 per cent of the earnings. Thus, when the earnings are from 50,000 marks to 54,800 marks, the tax is 524 marks; and it increases 48 marks for every increase of 4800 marks in the earnings. In this class, then, the tax is simply a graded tax on earnings assessed directly on each business. The assessment districts are the provinces and the city of Berlin; and, of the assessors for each district, two thirds are chosen by the committee of the province (*Provinzialausschuss*), and one third are nominated by the Minister of Finance (*Gesetz*, §§ 9, 10).

For the other three classes average rates are prescribed: for Class II, 300 marks; for Class III, 80 marks; and for Class IV, 16 marks. This rate is the average tax to be collected from the taxpayers in any given assessment district. The assessment district for Class II is the *Regierungsbezirk;* for Classes III and IV, the *Kreis*. The taxpayers rated in the same class and district constitute a tax association (*Steuergesellschaft*), on which the total tax for that class in that district is assessed (*Gesetz*, § 13). This total is, of course, the product obtained by multiplying the number of business undertakings represented in the association by the average rate for the class in which it belongs. If, for instance, in a given district there are 100 businesses rated in Class III, the total tax in that association will be (80 × 100 =) 8000 marks. The distribution of this total among the individual taxpayers is intrusted to a tax committee, the *Steuerausschuss*, the members of which are elected by the association from its own members. But the chairman is a commissioner of the government appointed to represent the interests of the state (§§ 15, 25). In the election of the committee the suffrage is limited to one vote for each business taxed. The size of the business is, therefore, not taken into consideration; and, where there are several proprietors, only one of them can vote. In this way it is hoped to secure assessors who possess the confidence of the taxpayers, have a practical acquaintance with the local business conditions, and will distribute the tax equitably and satisfactorily. This feature of the law is not new. It was adopted when the business tax was introduced in 1820, and in its workings is said to have given general satisfaction.

In assessing any individual business, the committee is limited to a choice among the optional rates prescribed in the law for each class. In Class III, for instance, there are 18 such rates, ranging from a minimum of 32 marks to a maximum of 192 marks (*Gesetz*, § 14). Moreover, the rate selected in any case may not exceed 1 per cent of the earnings of the business taxed. This rule, however, does not apply to a business rated on the basis of capital when on the basis of earnings it belongs in a lower class (*Gesetz*, § 15, 2). Acting under these limitations, the committee is to distribute the tax according to their knowledge or estimation of the amount of the earnings.

In this intention to collect about 1 per cent of the earnings,[1] and in most cases not more, is found the explanation of the scale of rates which is given below. The maximum rate in each class is nearly 1 per cent of the maximum earnings in the earnings scale of classification; and the minimum rate, although considerably less than 1 per cent of the minimum earnings in that scale, is but little more than 1 per cent of the minimum earnings which a business might yield, and still be retained in the class in question on the basis of its capital.[2] The consequence is that the rates for the different classes overlap; that is, the minimum rate for each class is less than the maximum rate for the next lower class. This allows a considerate treatment of businesses which are rated in a given class on the basis of capital, but which, as regards earnings, belong in the next lower class. The arrangement is an ingenious one, and has some results which are worth noting.

[1] In studying the Prussian business tax, and most of the other taxes levied by European countries upon business or property invested in business, the American student should observe particularly the moderate rates of taxation which are imposed. He should contrast, for instance, the Prussian tax of 1 per cent of the presumed *income* with the American property taxes of 12, 15, and even 20 dollars in the thousand of the *capital value* of factory buildings, machinery, stocks of goods, and the like. A tax of 15 dollars on every 1000 dollars of capital invested in a business is, if the earnings are 6 per cent, — or 60 dollars per 1000, — equivalent to an income tax of 25 per cent. Undervaluation of the property may reduce the tax, and usually does so; but if the property is assessed for 50 per cent of its true value, the tax of 15 dollars is 12½ per cent of the income. — Ed.

[2] In Class IV there is, as we have remarked, no such minimum limit for the earnings. But the low minimum rate, 4 marks, makes it possible to keep the tax below 1 per cent until the earnings fall below 400 marks.

		Rates
Earnings from 1500 to 4000 marks, or Capital from 3000 to 30,000 marks,	= IV . . .	4 8 12 16 = average tax for IV. 20 24 28 32 36
Earnings from 4000 to 20,000 marks, or Capital from 30,000 to 150,000 marks, and earnings not less than 3000 marks,	= III . . .	32 36 40 48 56 64 72 80 = average tax for III. 88 96 108 120 132 144 156 168 180 192
Earnings from 20,000 to 50,000 marks, or Capital from 150,000 to 1,000,000 marks, and earnings not less than 15,000 marks,	= II . . .	156 168 180 192 228 264 300 = average tax for II. 336 372 408 444 480
Earnings not less than 50,000 marks, or Capital not less than 1,000,000 marks, and earnings not less than 30,000 marks,	= I	336 372 408 444 480 524 on 50,000–54,800 earnings. 572 on 54,800–59,600 " 620 on 59,600–64,400 " Etc. Etc.

In the first place, it is obvious that the transfer of any given business from one class to the next lower need not necessarily reduce the tax it has to pay; and conversely, of course, its transfer to a higher class need not raise the tax. For instance, a business with a capital of 150,000 marks, and earnings

amounting to 18,000 marks, might either be rated in Class II on the basis of capital or in Class III on the basis of earnings, without making any difference in the tax the owner is called upon to pay. For in either class he may be assessed 156, 168, 180, or 192 marks. In that case, it might well be a matter of indifference to him in which class he was rated; but in the yield of the tax to the public treasury it would make a very important difference. For, if the business is retained in Class II, it yields the average rate for that class, — namely, 300 marks, — which has to be raised by the association in which the business is taxed. If, however, it is transferred to Class III, it will only yield 80 marks, the average rate for that class. It is obviously for the interests of the treasury to have this business retained in Class II. Its transfer to Class III means a loss of 220 marks; and yet the owner of the business may, as we have seen, have no special inducement to protest against his retention in Class II. That is not the case, however, with the association to which he belongs; for it pays over to the public treasury 300 marks on his account, while it receives from him only 180 marks. It would therefore gain 120 marks if this taxpayer were transferred to Class III; and in that class he will be welcomed, for he adds but 80 marks to the total tax of the association, to which he contributes 180 marks.

The arrangement has this advantage, as it seems to me: It allows the taxpayer who is on the border line between two classes to pursue his own business affairs without giving himself much concern as to which class he is rated in. He can leave that question to be decided by the representatives of the associations interested and the government officials. In making the classification, the friction must come principally at this point. The fiscal interests of the state demand that the business should be classified in the higher class, those of the two associations that it should be classified in the lower. It is not the state *versus* the individual taxpayer, but the state *versus* a group of taxpayers, or their representatives, no one of whom has any special reason to be more interested in the decision than another. It is the classification which determines definitely the amount which the state is to receive from the tax and the amount which each association — not each individual taxpayer — is to

contribute. After the classification is settled, therefore, any further conflict of interests is between the members of the same association, each of whom will of course find it for his advantage to see that he does not pay more than his share of the total tax of the association, or, what is the same thing, to see that other members do not pay less than theirs.

It follows that, so far as the returns from the tax are concerned, it is only necessary to ascertain the earnings or capital of a business within rather wide limits, — namely, the limits which determine the classification,— and the taxpayer may be called upon to state where within these limits his business belongs (*Gesetz*, § 55); but any more definite statements as to his earnings or capital cannot be required of him. He may, however, be required to state in what business or businesses he is engaged, where they are located, the number and kind of workmen employed, the nature and quantity of machinery in use, including the motive power of the works, or to answer any other questions in regard to the outward indications of the extent of his business (*Gesetz*, § 54). The chairman of the tax committee, moreover, has the right to inspect any place of business or manufacture during working hours (§ 25). But the books of the business cannot be examined without the owner's consent (§ 27), and the assessors are bound by oath to keep secret all information obtained in the exercise of their office (§ 49).

It must not, however, be forgotten that in the assessment of the income tax the written declaration is required. These declarations can hardly fail to be of great assistance in the assessment of the business tax. In many cases, the personal income of the taxpayer will be identical with the earnings derived from the business in which he is engaged; and the Introduction to the business tax law calls attention to the urgent desirability of selecting for chairman of the tax committee the chairman of the income tax assessment commission for the same district, "on account of the substantial identity of the materials used in ascertaining industrial income and business earnings." [1]

[1] By a law of 1893 this tax was made a local tax. Its yield at a comparatively recent date was 20,000,000 marks. — ED.

57. License Taxes in Massachusetts. — Apart from the general property tax, which, of course, reaches capital, the common form of business taxation in the United States is the license tax. Many states and probably all municipalities impose license taxes upon various occupations.[1] Except in the South, the state taxes are confined largely to licenses for the sale of liquors; the Southern states, however, have a most extensive system of license taxes. Municipal licenses generally cover a wider range of occupations than the state taxes, and in Southern cities are frequently oppressive.

Confining our attention to the license taxes imposed by the states, we may consider first the case of Massachusetts:[2]

The commonwealth imposes a tax upon the privilege of selling spirituous and malt liquors within the commonwealth. Every person desiring to engage in such business must first obtain a license from the authorities of the city or town in which he desires to do business, and pay the license fee imposed. The amount thus collected is divided between the commonwealth and the city or town in which the license has been granted, the city or town receiving three fourths and the commonwealth the remaining one fourth of the receipts.

A statute of the year 1888 limited the number of licensed places in any city or town which votes to grant licenses, to one licensed place for every thousand persons of the population of the city or town, as enumerated in the last preceding state or national census. There are some exceptions to this general rule. The most important is that for the city of Boston, which is allowed to have one license for every five hundred persons of the population. Certain minor exceptions are also made in favor of summer resorts having no settled population the year round. Every town, however small, is entitled to grant one license.

* * * * * * *

The licenses are of six sorts. With the exception of the sixth class, which is distinguished by the person to whom the license

[1] For an account of license taxes, see Ely, Taxation in American States and Cities, 203–209.

[2] From the Report of the Commission on Taxation, 1897, pp. 26–27.

is granted, the classification is based on two grounds of distinction; namely, (1) whether the liquor is to be drunk on the premises or not, and (2) on the sort of liquor to be sold. The classification in the statutes is as follows:

First Class. — To sell liquors of any kind, to be drunk on the premises.

Second Class. — To sell malt liquors, cider, and light wines, containing not more than fifteen per cent of alcohol, to be drunk on the premises.

Third Class. — To sell malt liquors and cider, to be drunk on the premises.

Fourth Class. —To sell liquors of any kind, not to be drunk on the premises.

Fifth Class. — To sell malt liquors, cider, and light wines, containing not more than fifteen per cent of alcohol, not to be drunk on the premises.

Sixth Class. —To druggists and apothecaries, to sell liquors of any kind for medicinal, mechanical, and chemical purposes only, and to such persons only as may certify in writing for what use they want it.

The license fee varies for the different classes. A statute of 1888 fixed the minimum fee to be charged by cities and towns at the following figures; for a license of the first class, $1000; for a license of the second class, $250; for a license of the third class, $250; for a license of the fourth class, $300; for a license of the fifth class, $150; for a druggist's license, $1. A city or town may charge as much more than these minimum fees as it may deem proper.

The following figures show the yield of the tax to the commonwealth, which is one quarter of the total yield, for a series of years:

1890	$426,309.62	1894	$544,292.50
1891	543,117.85	1895	682,099.36
1892	504,979.81	1896	669,602.17 [1]
1893	485,385.56		

58. License **Taxes** in **Maryland.** — Professor T. S. Adams gives the following account of license taxes in Maryland:[2]

[1] Since 1896 the revenue has been as follows:

1897	$780,977	1901	$811,683
1898	770,524	1902	843,146
1899	733,467	1903	775,665
1900	805,191	1904	802,294 — ED.

[2] Studies in State Taxation, edited by J. H. Hollander. Johns Hopkins University Studies in Historical and Political Science, Series XVIII. Reprinted by consent of editor, author, and publisher.

Licenses in Maryland date from an early period, although the most important were first levied in the second decade of this century. In 1780 the marriage license was imposed, and an annual tax of £15 upon billiard tables was levied in the same year. In 1819 the broker's license was introduced in the form of a tax of $500 per annum on every broker dealing in bank notes or lottery tickets. The trader's license, auctioneer's license, and ordinary's license date from 1827. From this time until about twenty-five years ago the state derived its principal revenue from this source. During the twenty-two years, 1877–1898, the various licenses yielded about 33 per cent of the total tax receipts.

Forms of license taxes.— Besides the quasi-license taxes to be treated with the corporation taxes, the following license taxes are imposed in Maryland:

1. Auctioneers in Baltimore city pay $450 to $750, according to the amount of sales. In the counties, auctioneers pay the trader's license upon the value of the stock on hand. Receipts in 1898, $3822.

2. Brokers pay special charges ranging from $100 for exchange, insurance, and pawnbrokers, to $18.75 for grain, coffee, cotton, and sugar brokers. Receipts in 1898, $18,952.65.

3. Hawkers and peddlers pay from $100 to $200 for each county in which they sell, according as they travel on foot or with horse and wagon. In eleven counties they pay $300 when they travel with a wagon and two horses. Receipts in 1898, $3012.91.

4. Traders' licenses vary from $12 paid on a stock of $1000 or less, to $150 paid on a stock worth $40,000 or more. Receipts, in 1898, $188,879.44.

5. Billiard tables. The annual license tax on billiard tables rented or conducted for a profit is $50. Receipts in 1898, $5604.27.

6. Liquor dealers selling in quantities of more than one pint pay licenses varying from $18 on a stock worth less than $500, to $150 on a stock worth more than $30,000. Dealers taking out an $18 license must pay in addition the trader's license of $12. Receipts in 1898, $10,696.88.

7. Ordinary keepers pay from $25, where the house occupied

has a rental value of $100 per annum or less, up to $450, where the house has a rental value of $10,000 or more. Receipts in 1898, $11,877.89.

8. Saloons and oyster houses in the counties pay $50 per year. Receipts in 1898, $33,044.44.

9. High liquor license. In Baltimore city and Ellicott city all liquor dealers, saloon keepers, etc., pay an annual license of $250. Receipts in 1898, $546,880.14.

10. Oyster dredger's license. Owners of boats engaged in dredging oysters pay $3 per ton annually. Receipts in 1898, $35,693.75.

11. Oyster tongers pay from $2 to $5 a year, according to length of boat. Receipts in 1898, $12,925.24.

12. Oyster canners pay one tenth of one cent upon every bushel of oysters shucked. Receipts in 1898, $4853.92.

13. Oyster measurers pay ten cents per 100 bushels measured. Receipts in 1898, $909.20.

14. Net fishing. Three cents for each square fathom of seine, and one cent for each square fathom of gill net. Receipts in 1898, $204.85.

15. Commercial fertilizers. Every manufacturer or importer of fertilizers is required to pay $5 for the first 100 tons sold, and $2 for each additional 100 tons. Receipts in 1898, $9150.

16. Exhibition licenses. Theatrical companies, shows, circuses, etc., pay in addition to local licenses, $30 per year, or $1 per exhibition, in the counties. In Baltimore city theatrical exhibitions and circuses pay to the state $3 each night; other exhibitors, $10 per week. Receipts in 1898, $3347.71.

17. Cigarette license. To sell paper-wrapper cigarettes dealers are required to pay a special license of $10 per year. Receipts in 1898, $11,160.20.

18. Race and fishery. To sell liquor at horse races and fisheries, special licenses are issued which cost $4.50 and $6.50 respectively. Receipts in 1898, $41.80.

Critical suggestions. — Judged by McCulloch's empirical standard, the license taxes are the best taxes we have. They are easily and cheaply collected, very productive, and cause little irritation or complaint. Considering how completely the faculty or *quid pro quo* theory fails to explain some of our most satis-

factory taxes (as, for example, the inheritance tax), there seems no reason why we should advocate the abandonment of license taxes because they have no apparent philosophical basis. Many of these licenses, notably the high liquor, cigarette, and exhibition licenses, are sumptuary measures. The first of these has had a most beneficial influence in Baltimore, and there seems little reason why we should not regulate by taxation if the measure of regulation desired by the public can be thus secured. The traders' licenses are not excessive and it is improbable that prices are appreciably affected by them. If the number of such fixed charges could be increased without causing more injustice or irritation than the average license of the present, the increase would seem, *pro tanto*, a most desirable substitute for the property tax.

Many of the licenses are specially devoted to the interests of the particular branch of trade from which they are drawn. Thus, most of the oyster licenses are imposed for the sole purpose of maintaining the supremacy of Maryland in the oyster trade. The same motive explains the fertilizer license. Baltimore is now the largest manufacturing center of the fertilizer industry in the country. In order to keep the standard of these goods high this license is imposed and the proceeds devoted to the maintenance of a chemical laboratory where the inspection and analysis of fertilizers is constantly going on.

In glaring contrast to most of the licenses are those required of peddlers and auctioneers in Baltimore. The latter occupation is a virtual monopoly in Baltimore, only eight licenses being issued in 1898. The law provides that auctioneers shall be appointed by the governor and shall pay $450 per annum if their sales — excluding real estate and houses — are less than $150,000. Where such sales amount to more than $150,000, the license costs $750. Whether this tax meets the approval of those who can afford to pay it, is not plain. But it certainly renders one legitimate vocation inaccessible to the poorer classes and undoubtedly diminishes the revenue that would accrue from this source if the licenses were of normal amount.

The excessive license charge required of peddlers furnishes another instance of explicable but unjustifiable trade antipathy. Scarcely a session of the General Assembly passes without these

charges being increased or extended over counties where formerly they did not apply. If auctioneers and peddlers thrive so well and it requires such an effort to repress them, it is only proof that they are performing some economic function better than the ordinary traders, and they should be encouraged, not discouraged. The excessive peddler's license is due in some degree to a survival of the Jew-baiting instinct. This charge is undoubtedly aimed at the industrious Jewish itinerant who peddles notions, since hawkers of fish and green provisions are exempt.

Licenses are granted by the clerks of the circuit courts. Sheriffs and constables are enjoined to make diligent search for violators of the law, and informants in every case are given one half of the penalty imposed. The law is generally well enforced and there are no wholesale evasions. Some of the penalties provided exhibit peculiar prejudices similar to those noted in the case of peddlers; for example, a penalty of $500 is imposed upon people doing a broker's business or keeping a public billiard table without a license, while the pecuniary penalty for selling liquor without a license varies from $50 to $200.

The more serious problem to be solved in connection with licenses is not whether they should be retained, but whether their proceeds should go to the state or the local division in which they are collected. The state retains one fourth of the proceeds of the high liquor license collected in Baltimore. It retains the entire proceeds of the traders' licenses collected in Baltimore — nearly $104,000 in 1898. Two questions are frequently asked by the citizens of Baltimore: Why should any of this money go to the state at all, and, if the state has a just claim to the proceeds of license taxes, why should it take a part in the one case and the whole amount in the other?

The answer to the latter question is not difficult to find. The city of Baltimore, in so far as its liquor trade is concerned, is subjected to heavier taxation than other local districts. A portion of this taxation, about equivalent to the amount of taxes collected from liquor dealers in other parts of the state, is retained by the state in order to place Baltimore upon an equality with other local divisions in this respect. The justice of this apportionment must be acknowledged if it be decided that the state

has a better claim to the proceeds of licenses than the several local divisions.

The mayor of Baltimore has recently criticised the practice of using the traders' and other licenses for state purposes. The public expenses entailed by traders are borne by the city; the logical fund for the payment of these expenses, he claims, is that derived from the licenses imposed upon traders.

The question involved is clearly one of equity, to be decided by reference to the general principle in accordance with which license taxes are imposed. If licenses are paid in return for and in proportion to public services rendered, the proceeds, speaking generally, should go to the local districts in which they are collected. If they are payments for the grant of public privileges, the proceeds should go to the state.

In origin, the license tax is closely akin to the modern franchise tax, and appears, in its historical aspect, as the price of the privilege to do business; in Mississippi, for example, the tax is still known as the privilege-license tax. The grant of such privileges lies wholly within the province of the sovereign power; it is not within the ordinary power of a municipal corporation either to authorize, prohibit, or circumscribe by license the pursuit of a calling or trade not inimical to the public health, morals, or safety. In consequence of these facts, the payments for the grants mentioned should be retained by the power which conferred them; and this power is the state. This interpretation of the nature of the license tax is further supported by the difference in the burden imposed upon the several kinds of business. The broker and the peddler have no extensive stocks or establishments necessitating the maintenance of police and fire departments, yet they pay higher licenses than ordinary traders. Moreover, the license charges are substantially uniform throughout the state, irrespective of the degree of protection afforded by the various local governments.

It is admitted that the above is an ultra-theoretical view of the nature of the license tax, but the distribution of taxation among individuals and the distribution of the proceeds of taxation among the several governmental divisions are problems which are essentially theoretic. It is also admitted that there are many weighty arguments which may be adduced in support

of the justice of the mayor's plea. But in the opinion of the writer, the distinctive features of the license stamp it unmistakably as a state tax as distinguished from a municipal charge.

59. License Taxes in Mississippi. — Even more inclusive is the system of license taxes of Mississippi and most other Southern states. Dr. C. H. Brough has written the following account of the Mississippi system:[1]

Mississippi, in accord with the general practice of Southern commonwealths, imposes a privilege-license tax on well-nigh every occupation. An examination of the present revenue laws reveals the fact that there are one hundred and nineteen occupations to which licenses must be issued as a condition precedent to the transaction of business.

The importance of the privilege-license system in Mississippi is conspicuous. From the time when the dominant landed proprietors of an antebellum régime demanded the taxation of other objects than their farms and estates, to the present day, when the need of revenue and a sentiment in behalf of local protection sustains what would seem to be a fiscal anachronism, the privilege-license system has been an important source of revenue.

Of recent years the number of occupations subject to the payment of licenses has multiplied and the charges have increased. In the early laws we found the privilege schedule limited to auction sales, billiard tables, bowie knives, nine-pin alleys, peddlers, race horses or tracks, taverns, groceries, and theaters. An examination of this list shows that the articles specified are principally luxuries, the restricted consumption of which was deemed desirable.

In striking contrast to this limited use of the privilege system is that implied in the revenue laws of 1898. Here the predominance of the idea of revenue over regulation permits of no discrimination between necessary goods and luxuries, and between useful and useless occupations. Railroads and lawyers are placed on the same footing with merry-go-rounds and dealers in

[1] Studies in State Taxation, edited by J. H. Hollander. Johns Hopkins University Studies in Historical and Political Science, Series XVIII. Reprinted by consent of the editor, author, and publisher.

hopfenweis. Bedspring dealers are as important in the eye of the law as boarding-house keepers.

This enlargement of the scope of the privilege-license system indicates a gradual movement away from sole dependence upon the general property tax, a movement accelerated by the practical defects of the latter and the need of applying a fiscal differential to the modern complex industrial organization. The rigidity of the state constitution has necessitated the taxation of corporations in the form of a privilege-license tax. That the taxation of corporations has taken definite form in the privilege-license system may be seen from the fact that railroad, express, sleeping-car, telephone, telegraph, and insurance companies are subject to the imposition of a privilege tax on those elements supposed to represent their taxable capacity.

Accident insurance companies pay $250 per annum; life insurance companies a graduated tax of $250 for the first year, $500 the second, $750 the third, and $1000 for the fourth year and thereafter. Insurance agents are also subject to a privilege tax, rated according to the size of the city or town where their business is transacted. Thus, an insurance agent doing business in a city of 5000 or more inhabitants, pays $40; in a city of more than 2000 and less than 5000 inhabitants, $25; in a town or village of less than 2000 inhabitants, $20; other insurance agents, $10.

Express companies pay a privilege tax of $500, together with a tax of $1 for each mile of railroad along which they operate, and a local property tax according to charter exemption and gross earnings. Railroads are divided into four classes according to gross earnings. The first class pays $20 per mile; the second, $15; the third, $10; and narrow gauge, $2. An interesting provision was inserted in the laws of 1898, whereby railroads claiming exemption from state supervision under maximum and minimum provisions in their charter are compelled to pay an additional privilege tax of $10. Sleeping and palace car companies pay $200 each. Telegraph companies pay $250; or if the line is less than 1000 miles, 25 cents per mile. Telephone exchanges are graded according to the number of subscribers. Thus, an exchange with 20 subscribers or less pays $5, while one with more than 150 subscribers pays $100.

Other corporations following specified lines of business fare the same as insurance, transportation, and transmission companies, paying a privilege tax, either fixed or graduated, on some element of some taxable capacity. The element of taxable capacity varies greatly according to the nature of the business. On cotton gins the tax is fixed; on cotton compresses it varies with baling capacity; on cotton-seed oil mills, with the amount of capital stock. Auctioneers, barber shops, bicycle dealers, brokers, coal dealers, ferries, hotels, junk dealers, livery stables, meat markets, photograph galleries, restaurants, theaters, warehouses, electric light, gas and water-supply companies, pay in proportion to the size of the city, town, or village in which they are located. Building and loan associations, fertilizer companies, and stores pay in proportion to the value of their stock. Brickyards, ice factories, liquor dealers, lumber yards, and sawmills pay in proportion to their output. Billiard and pool tables, bottling establishments, breweries, bands of gypsies, circuses, cigarette dealers, dealers in deadly weapons, dentists, druggists, guarantee companies, hack lines, horse traders, lawyers, lightning-rod agents, live-stock insurance companies, piano factories, second-hand clothiers, stave and spoke factories, pay a fixed amount.

Peddlers and railroad eating houses furnish interesting exceptions to the four bases of classification enumerated, *i.e.* location, value of stock, output, and fixed amount. Peddlers pay in proportion to their transportation facilities. Thus, a peddler with one horse or mule, and wagon, is taxed twice as much as a peddler on foot; a peddler with two horses or mules, and wagon, twice as much again. Railroad eating houses pay in proportion to the number of daily trains making stops for meals. Where two or more passenger trains are running on trunk lines, the privilege tax is $125; where there is only one such train, $50.

However variable may be the basis of assessment, the imposition and collection of the privilege tax are comparatively simple. The law provides that insurance, telegraph, express and sleeping car companies, building and loan associations, and commercial agencies shall pay the tax directly to the state auditor. All other corporations and persons obtain their license from the county sheriff. In any case where it is inconvenient to obtain

the license from the sheriff, it may be procured from the auditor. The auditor is required to prepare license blanks and issue them to the sheriff of the county, who is held responsible for the collection. Privilege taxes thus collected must be reported monthly and paid into the state treasury as other taxes, and any defalcation by a delinquent collector must be published at once by the auditor. Licenses are good from the day of issue, except in the case of dram shops, where they date from the granting of the license. No license can be granted in a "dry" county, or where the majority of the legal voters petition the board of supervisors to prohibit the opening of saloons. A failure to exhibit a license on demand is considered *prima facie* evidence that it has not been paid and that the privilege is unlawfully exercised. For non-payment or forfeiture a penalty is imposed not less than double the tax imposed, or imprisonment in the county jail not more than six months, or both.

Under no circumstances can any privilege be taxed by a county or municipality to an amount exceeding 50 per cent of the state license; and a privilege license imposed on insurance, telegraph, and sleeping-car companies, building and loan associations, is entirely exempt from county and municipal taxation. With the exception of the 50 per cent local tax referred to, the privilege-license system in Mississippi is solely a source of commonwealth revenue.

As a supplement of its pension system, the state exempts indigent Confederate soldiers and sailors, their wives or widows, from the payment of the tax on all privileges save those on dealing in liquors, cigarettes, deadly weapons, jenny-lind or pool tables, or like contrivances kept for amusement, second-hand clothing, and hotel keeping. Thus, the privilege-license system in Mississippi operates directly as a means of local prohibition and as a source of commonwealth revenue, and indirectly, as a bounty to Confederate soldiers and sailors. As a supplementary fiscal device levied on general categories, the system is popular and practically beneficent. Especially is this true of the railroad privilege tax.

Until very recently it has been well-nigh impossible to collect any property tax from railroads because of their claims of charter exemption. The privilege tax has been the only way of

reaching them. Thus, in 1888, a typical year, the percentage receipts from railroad property amounted to only $210, while the railroad privilege tax aggregated $140,792.

Recent reductions in the rate per mile of the railroad tax imposed,[1] and the legal compulsion placed upon railroads to pay both privilege and percentage taxes, have reduced both the absolute and relative importance of the railroad privilege tax. Thus, in 1898, the percentage receipts from railroads were $109,833, while the railroad privilege tax was only $26,625. It may, however, be confidently predicted that the decline in the importance of the railroad privilege is only temporary. An estimate of gross earnings is more satisfactory to all parties concerned as a basis of assessment than a valuation of property. An increase in the rate per mile to its old proportions would place the railroad privilege tax on an independent footing and avoid the double taxation to which railroads are now subjected.

Although regressive, easily shifted, and undemocratic in theory, the privilege-license system is warranted in Mississippi by its practical results. It furnishes the state a revenue of over $300,000 per annum, and is regarded favorably by business men as a license charge rather than a business tax. Criticism is to be directed, not against the system *per se*, but against some of the bases of its assessment.

In many instances the criterion is purely arbitrary, selected without any reference to the ability of the persons taxed. Thus, all fire, accident, and life insurance companies, which are members of any traffic association, are assessed fixed amounts; while non-traffic companies are taxed 2 per cent on their gross premiums. With few exceptions the solvent companies of the state are members of traffic associations; and because of their agreements to maintain rates, the amount of business transacted, gross earnings, and other elements of their taxable capacity are utterly ignored. This is a useless display of anti-trust demagoguery.

In other instances the criteria selected, while not arbitrary,

[1] In 1888 the average state railroad privilege tax per mile was $83.33⅓, besides a county railroad privilege tax of $41.66⅔. In 1898, the state railroad privilege tax on first-class roads was only $20, and there was no county tax imposed. (Compare Auditor's Report, 1888, p. 106, with Mississippi Laws, 1898, p. 23.)

leave room for evasion and bear no relation to earning capacity. Thus, heavily bonded cotton-seed oil mills can escape entirely the tax levied in Mississippi on the capital stock of cotton-seed oil mills. Large cotton warehouses, which pay in proportion to the size of the place in which they are located, may profit at the expense of the smaller competitors located in a larger place. On the basis of taxation according to output, lumber yards having a large output obtained at great expense, may suffer in comparison with those having a smaller output obtained at proportionately less expense. These are merely typical illustrations of some of the practical defects in the bases of privilege assessments in Mississippi.

While it would be hazardous to fix arbitrarily upon a test of taxable capacity applicable to all cases, nothing but good could result from making the bases selected more thoroughly applicable to their particular cases. If the standard cannot be made uniform, it can at least be made correct. This must be done if the license-privilege system in Mississippi is to serve to any extent as a corporation tax.

CHAPTER XV

THE CORPORATION TAX

60. The General Corporation Tax. — The corporation taxes of the American commonwealths are either general taxes upon all corporations, with certain specified exceptions — for which special taxes are provided, or special taxes upon corporations engaged in certain branches of industry. The general corporation taxes sometimes apply to all companies, domestic or foreign, doing business within the state (as in the cases of Pennsylvania and New York), or to domestic corporations only (as in Massachusetts and New Jersey). The special taxes apply to railroads, banks, telegraph companies, insurance companies, and the like. This section will be devoted to the general corporation taxes.

The corporation tax of Massachusetts applies only to domestic corporations, and does not extend to banks, trust companies, and insurance companies, for which special methods of taxation are prescribed. The Massachusetts Commission of 1897 presents the following account of the working of the general corporation tax:[1]

First and most important is the general franchise tax on corporations chartered or organized under the laws of the commonwealth. This tax is designed to bring about the taxation of such corporations fully and fairly, in such manner as to reach all their property, and to reach it once and once only. It is unique in the tax experience of the states of the Union. No other state has adopted this precise mode of taxing the corporations whose corporate privileges depend on its laws.

[1] Report, pp. 14–17, 68–71.

In its main outlines the plan of the tax is as follows: The real estate and machinery of all corporations situated within the commonwealth are assessed by the local authorities, and the taxes on them are paid directly to the respective cities or towns. The remainder of the property of the corporation, as indicated by the market value of the outstanding shares, over and above the taxed value of the real estate and machinery, is taxed by the commonwealth under the corporation or franchise tax, and payment is made in the first instance to the treasury of the commonwealth.[1] The proceeds, however, do not accrue *in toto* to the treasury of the commonwealth, but are divided in large part among the cities and towns of the state.

All corporations chartered by the commonwealth of Massachusetts, or organized under the general corporation laws, for the purpose of business or profit, having a capital stock divided into shares, are subject to this annual tax, entitled a tax upon their corporate franchise. The tax affects, therefore, corporations of the most various kinds, — manufacturing and trading establishments, street railways, gas and electric lighting companies, electric power companies, private water-supply companies, telegraph and telephone companies, and certain insurance companies. There are some important exceptions, however, to the scope of the tax. Saving banks are taxed differently; banks and mutual insurance companies are also treated in a different way. For the banks a different method was devised, mainly because of the safeguards which the federal government has thrown about the national banks. Certain mutual insurance companies, on the other hand, are taxed on a different basis. Besides these important exceptions there are some others of less consequence; as, for instance, in the case of coal and mining companies and companies formed to build and operate railroads in foreign countries.

The general corporation tax is assessed by the tax commissioner with the aid of returns from the corporations and from the local assessors. Every corporation must return to the tax commissioner, under oath of its treasurer, a complete list of its shareholders, their places of residence, the number of shares

[1] By an amendment passed in 1903 the valuation of the intangible property of a corporation is not to exceed 120 per cent of the value of the tangible assets. — ED.

owned by each on the first day of May, the amount of the capital stock of the corporation, its place of business, the par value and the market value of the shares on the first day of May, and a statement of the works, structures, real estate, and machinery owned by the corporation and subject to local taxation within the commonwealth; in the case of railroad and telegraph companies, the whole length of their lines and the length of so much of their lines as is without the commonwealth; in the case of other corporations, the amount, value, and location of all works, structures, real estate, and machinery owned by them and subject to taxation without the commonwealth.

The assessors of each city and town also return to the tax commissioner by the first Monday in August the names of all corporations established in their respective cities or towns or owning real estate therein, and a statement of the works, structures, real estate, and machinery owned by each corporation, and the amount for which such property is valued for local taxation. From these returns, or otherwise at his discretion, the tax commissioner ascertains the true value of the shares of each corporation, which is described in the statute as the "true value of its corporate franchise." The shares of many corporations being sold from time to time on the open market, their market value is comparatively easy to ascertain; but with the greater number of corporations affected by the tax, the shares are seldom, if ever, sold or offered for sale in open market. In the case of such corporations the tax commissioner procures from the corporation a statement of the condition of the company, of its assets and liabilities. In case of refusal to render a statement of condition, the commissioner is authorized to examine the books and to examine on oath the treasurer and directors. From this information, and such other information as he may be able to procure, the commissioner proceeds to put upon the corporation what he considers to be a just estimate of the true value of its "corporate franchise."

From the aggregate value of the shares of the company thus determined, the tax commissioner makes the following deductions. First, in the case of railroad and telegraph companies whose lines extend beyond the limits of the state, such portion of the whole valuation as is proportional to the length of that

part of their line lying without the commonwealth is deducted; and, further, an amount equal to the value of their real estate and machinery located and subject to taxation within the commonwealth. Second, in the case of a telephone company, so much of the whole valuation as is proportional to the number of telephones used or controlled by it without the commonwealth, and also the value of all stock in other corporations held by it upon which it has paid a tax for the year preceding. Third, in case of an insurance company, the value of mortgages on real estate held by it subject to local taxation. Fourth, in the case of all other corporations, an amount equal to the value of the real estate and machinery subject to local taxation within or without the state. The total value of the shares, thus diminished by allowance for real estate and machinery already taxed, and by the mileage and other apportionment in the case of railroad and telegraph and telephone companies, may be called the taxable corporate excess.

This corporate excess is then taxed at a rate which is roughly the average rate of taxation in the commonwealth. It is determined by an apportionment of the whole amount of money to be raised by taxation upon property in the commonwealth during the current year upon the aggregate valuation of all the cities and towns for the preceding year.

The amount of the tax thus computed on corporate excess is then collected by the treasurer of the commonwealth. The tax commissioner notifies the treasurer of each corporation of the amount of its tax; and the ease and certainty with which penalties can be applied to domestic corporations cause the taxes to be paid, as a rule, promptly, and with a minimum of expense for collection.

The tax having been paid into the treasury of the commonwealth, it is in part distributed among the cities and towns, in part retained by the state. On the principle that personal property is taxable at the place of the owner's domicile, such proportion of the tax as corresponds to the proportion of stock owned by persons residing in the commonwealth is credited and paid to the several cities and towns where (as may appear from the corporation's list of stockholders or from such other evidence as the tax commissioner may procure) such shareholders

resided on the first day of May next preceding. The remainder of the tax, which represents the shares in Massachusetts corporations owned by persons who are not residents of any city or town in the commonwealth, is retained in the state treasury.

Yield of the Tax in 1896 [1]

Net amount assessed by the tax commissioner	$3,829,528.02
Amount certified as due to cities and towns	2,729,665.85
Balance accruing to the commonwealth	$1,099,862.17

The taxation of shares in domestic corporations is in striking contrast with that of bonds, foreign stocks, and other securities taxable to the holder. Here there is no demand for a statement from the individual taxpayer, no doomage by local assessors, no guesswork, no possibility of evading or diminishing taxes by change of domicile, no question of double taxation. The real estate and machinery are assessed locally; doubtless not with perfect equality and justice, but probably as carefully as would be possible under any system. The corporate excess is taxed at a uniform rate by the state. The taxes are regular and certain. They are heavy, and they yield a large revenue. The rate of taxes on corporate excess for the last fifteen years has been from year to year not far from $15 per $1000, or about one and one half per cent on the capital. The assessment in 1896 was $3,829,528.02. Yet little complaint is heard regarding these taxes, — a signal proof that the taxpayers accommodate themselves, if not with ease, at least without serious complaint, to burdens which are steady, regular, predictable, and for which in consequence they are able to make calculations and adjust their affairs.

The corporation tax is particularly simple and is assessed with unerring exactness, in the case of large and well-known corporations, whose shares are regularly dealt in, and consequently have a publicly recorded value. Railways, banks, the larger

[1] In 1904 the gross receipts were $5,166,900, of which sum $1,203,000 was the share of the state. The total assessment fell upon the various classes of corporations as follows:

Street railways	$912,730
Other public service corporations	2,686,226
Business corporations	1,567,944
Total	$5,166,900 — Ed.

manufacturing corporations, and others whose stocks are frequently quoted, are taxed without a word of inquiry and without a possibility of escape. A very large number of miscellaneous corporations are in a somewhat different position. Their shares are held by a few individuals, are rarely transferred, and are without a quotable market value. In these cases the statement required by law from the corporation itself as to the market value of its shares is important. The tax commissioner may further require a transcript of the balance sheet, and other information which he deems desirable. No doubt there is a possibility of understatement by a corporation of the value of its stock, and a possibility of manipulation of the balance sheet. There is reason to believe that sometimes the taxes on corporate excess are partially evaded in this way; but the evasions are insignificant, in comparison with those as to taxable securities. In any case they affect but a small proportion of the total taxes collected from Massachusetts corporations. As a whole, this part of our tax system is an excellent example of the method of taxing corporations at the source, and of refraining from any dealings with the individual holder of corporate securities, — a method admitted on all hands to be the simplest, most efficient, and most equitable in the taxation of corporate property.

It is unfortunate that similar accounts of the general corporation taxes of other states are not available for use in this volume, but the following data may be presented:

(*a*) New York has devised what has been called justly the "most complicated and clumsy" methods known of taxing corporations. Besides an "organization tax" upon newly formed companies, which yielded $474,667 in 1889, and miscellaneous taxes on special kinds of corporations, New York has a general corporation tax, in addition to taxes upon the property of corporations. Every corporation organized under the laws of the state must pay an annual tax computed upon the amount of its capital stock employed within the state, the rate of taxation depending upon the dividends which the corporation has paid. Foreign corporations, moreover, pay a similar tax for the privi-

lege of carrying on business within the state. In addition, real estate owned by corporations is taxed for state and local purposes; while their personal property is taxable for local purposes, although in most cases it manages to escape in whole or in part. Various exemptions and special taxes make the situation still more complicated.

(*b*) Pennsylvania imposes a general corporation tax upon all corporations, both domestic and foreign, except banks and foreign insurance companies, but makes certain exemptions for companies organized exclusively for manufacturing. This is in lieu of other taxation for state purposes. Companies subject to the tax pay five mills for each dollar of the actual value of their outstanding capital stock, common, special, or preferred; and four mills upon each dollar of the nominal value of their bonds or other outstanding obligations. In assessing the tax upon capital stock, suitable deductions are made for capital employed in other states.[1] The tax upon corporation bonds applies only to bonds owned by residents of the state, since those owned by residents of other states are not subject to the jurisdiction of Pennsylvania. In 1899 the tax on capital stock yielded $4,575,000; and that upon bonds, $1,149,000.

(*c*) The general corporation tax of New Jersey applies only to domestic corporations and does not extend to banks, railroads, and manufacturing or mining companies that have invested one half of their capital within the state. Of the corporations subject to the tax, some (such as telegraph, lighting, or insurance companies) pay a tax upon their gross receipts or earnings; while the remainder, which contribute the larger share of the receipts, pay a tax upon their capital stock. This latter tax is one tenth of one per cent upon the capital stock

[1] Thus domestic corporations receive an allowance for tangible property permanently located outside of Pennsylvania; foreign corporations pay only on the proportion of their capital invested or employed in Pennsylvania; railroads pay on a proportion of capital representing their mileage in Pennsylvania.

up to the sum of $3,000,000; one twentieth of one per cent upon capital stock in excess of $3,000,000 but not exceeding $5,000,000; and $50 upon each million of capital stock in excess of $5,000,000. This is a tax upon the franchise of the corporations, not upon their property, and does not exempt this property from other taxation. Therefore all real and personal property of corporations is taxable the same as the property of individuals;[1] but, as the state revenue is derived from other sources, the property of New Jersey corporations is in practice taxed only for local purposes. In 1899 the franchise tax yielded $1,332,000.

61. The Taxation of Railways. — The taxes imposed upon special classes of corporations often apply to railways, although in some states (as Massachusetts and Pennsylvania) railways are included in the general corporation tax. The present methods of railway taxation are described by Professor R. C. McCrea, as follows:[2]

During the past fifty years, progress in the development of methods of railway taxation has been characterized by the gradual decadence of the earlier practices of subsidy and of complete or partial exemption from taxation, and by the application of increasingly stringent and uniform tax arrangements. In the process of this transition, with but slight exceptions (as in the case of Pennsylvania, which from the outset avoided the general property tax in this connection), the practice of the states was the assessment of all real and personal property by local officials, in the same manner as with the similar property of individuals. And the adoption of this plan was not unwarranted by the conditions of the time. Up to 1850 the railways of the country were nearly all of a local character. At that time none of the great trunk lines had been formed. But changed condi-

[1] This does not apply, however, to banks, railways, and some other corporations, which are taxed in other ways.

[2] Annals of the American Academy of Political and Social Science, Vol. XV, 360 *et seq.* Reprinted with consent of the author and the Academy. The author, it should be added, has made some slight changes in the article.

tions soon began to appear. In 1851, for instance, various lines were brought together to form the New York Central Railroad; and in the few years following, the Baltimore and Ohio, Pennsylvania, and Erie lines were formed. As the result of changed conditions brought about by consolidations such as these, new tax requirements arose. Inadequate as had been the general property tax under local administration even under earlier conditions, it was now very soon shown to be entirely ill-adapted to this new office. Utter lack of uniformity in the operation of the system resulting from its local administration, facility of invasion, and failure of levies to measure even roughly the taxpaying capacity of the different companies, among other difficulties, necessitated from time to time the adoption of modifications and substitutions, which have at length resulted in present methods.

In the course of this process, certain changes of quite general prevalence among the states have been effected. In the first place, there has prevailed widely a tendency to tax transportation companies upon a different basis, or, to say the least, in a different manner from that which has been followed in the taxation of individuals. Thirty years ago the local general property tax was the main method applied to railroad taxation. Twenty years ago changes had already been so far effected that railroads were taxed on their property upon the basis of varied local assessments in less than one fourth of the states. And more recently the application of the early method has been so far abridged that it is now to be found in its original form in but four states and one territory. Those which still cling to the primitive method are Louisiana, New Mexico, Oregon, Rhode Island, and Texas, and in the case of Texas there is a supplementary tax based on a different principle.

There is still prevalent in many sections of the country, however, an attitude favorable to the taxation of individuals and of corporations upon the same principle and in the same manner. Such, for instance, is the notion which pervaded the deliberations of the extra session of the Michigan legislature in 1898, convened to consider the subject of railroad taxation. Such, likewise, is the express requirement in a number of state constitutions. But the preponderance of practice is in the other direction; even in the cases of those constitutional requirements

which have just been mentioned, their practical force has been, in large measure, destroyed by the decisions of the federal Supreme Court in a series of cases which hold that state constitutional provisions declaring that a certain large class of persons and corporations shall be taxed by general laws, uniform as to the class upon which they operate, allow a rule for railroads different from that which applies in the taxation of individuals.[1]

By way of explanation, however, it must be stated that in the majority of those cases where changes have been effected, the property tax has not been abandoned, but modified. There has been embodied in this growth simply an attempt to adapt the property tax to the most obvious requirements of a system of railroad taxation. The result of this process of adaptation has been the establishment of methods of railroad taxation which differ essentially both in their operation and in their administration from those employed in the taxation of individuals, and even of other corporations; railroad property is made a special class for purposes of taxation in that it is subject to assessment by state, not local, authorities. The New Jersey Tax Commission of 1897, in its report, very well points out the distinct character of the two in a statement which is generally applicable: "It will be readily seen that these two systems, thus described and contrasted, are not coördinate; there is no tribunal in the state clothed with powers in which the values of the one class can be contrasted with the values of the other; they run in parallel lines, so to speak, being two separate, independent systems." In fact, the incorporation of the franchise feature in the systems of many of the states has so far obscured, or at least modified, the workings of the original property tax system, as to effect by existing methods a substantial divorce from the methods applied in the taxation of individuals.

As an offshoot of this tendency toward railway taxes distinct from those employed in the taxation of individuals, has come a process of change in the direction of a growing centralization of the machinery of railroad taxation. With the widening scope of railway consolidation, effective local taxation of railways has come to be a practical impossibility. Experience has shown that the problem of railroad taxation is by so much ad-

[1] See State Railroad Tax Cases (92 U. S., 575).

vanced toward solution, as the progressive steps toward the formulation of a tax system tend to broaden the field of the application of that system; and legislative practice has of necessity followed these lines.

In the legislation of many of the states, one of the accompaniments of the centralizing tendency which is becoming more and more noticeable, is the practice of authorizing certain state officials to examine the books and papers of transportation companies for purposes of information in the making of assessments. There seems to be a growing desire to reach, for purposes of taxation, every company's full earning capacity, and the adoption and extension of this device is a step toward the attainment of that end. Whether its workings are effectual is at least questionable. The commissioner of railroads of Michigan, for instance, asserts that "that provision of the statute which gives the commissioner the right to examine books and papers is a humbug. It takes six months to examine a little broken bank in Lansing. How long would it take to examine the affairs of a great railroad?" But apart from any consideration of the ineffective character of the regulation, the fact of its increasing prevalence is still to be noted in state legislation. The growing advocacy of a uniform system of railway accounting deserves to be noted as tending in the same direction. Possibilities of railroad regulation, beyond the mere matter of taxation, are involved in these plans.

Beyond those general lines of change which have been progressing to a greater or less degree throughout the states, there remain to be considered certain more special changes which have been effected upon tolerably distinct lines in different sets of states, namely, those changes which have resulted in the adoption of methods resting upon the bases of property, capitalization, and business receipts; the latter two, broadly speaking, characterizing the states east of the Mississippi and north of the Ohio; and the first, the remaining sections of the country. This question is probably the most important one that arises in considering the development of the country's transportation taxes. It is also the subject of considerable controversy.

It has already been said that the early method in nearly all of the states was that of the local general property tax, and that

as time went on, various departures from that method were effected. In the majority of the states these departures took the form of a modification of the original property tax method. The plan of cash valuation of property, or of property and franchise, by state officials came into use. Even in 1880 the general property tax, although lying at the bottom of the systems employed in most of the states, was, in its primitive form, the exception rather than the rule; and during the two decades that have elapsed since 1880, the method of cash valuation of railroad property by state boards or officials has made still further inroads into those states where the local property tax was formerly in vogue. Such, for instance, has been the case in Arkansas, in Iowa, and in other states, where the demand for greater uniformity in administration necessitated this change. To be sure, the origin of this method in the general property tax, and its subsequent development along the lines of that system, do not warrant the expectation of close approach toward correctness of principle in its formulation, or of high degree of efficiency in the details of its operation. It is not surprising, when we consider the rapid growth of the country's external and internal traffic, that tax legislation has failed to adapt itself completely to the new requirements which have arisen as the result of this speedy growth. American legislative activity, particularly in the field of taxation, has always been conservative; and it is but a natural consequence of the conservative tendency to regard the tax on property values as the "measure of justice and equality" that the old principle has been embodied in the railway tax systems of most of the states.

The plan of railroad taxation based on cash valuation of property, or of property and franchise, is rather complex in its administration. As regards details, its operations are not identical in any two of the states; but its main features, in all of those states where it prevails, are the same. Certain designated officers of the various railroad companies are required to return sworn statements or schedules to state officials, setting forth in detail the length of line with all its tracks, and the proportion thereof in each tax district of the state, all personal property of every kind, all rolling stock, and often a detailed description of the construction of track and roadbed, the time spent in that

construction, and the value of materials employed. There is also required a full statement of all real estate owned or used in each tax district, of all stations, houses, or other buildings, and all equipments connected therewith, of the amount of capital stock, including its market value, or if there is no market value, the actual value of the shares, in some cases including a list of the shareholders and their places of residence, in addition to a statement of the total amount of all indebtedness, generally excluding current expenses. In some states the schedule must contain a statement of the respective companies' entire gross receipts, entire operating expenses, and entire net earnings, with a supplementary statement of the amount of such receipts, expenses, and earnings, resulting from business done exclusively within the state. Neglect to furnish these sworn schedules is generally attended with heavy penalties, and false statements are punishable as perjury. Furthermore, in many cases the state officials to whom these reports are made, are empowered to require additional statements, when necessary, and even, as provided in a number of states, to summon witnesses, to examine them under oath, and to compel the production of corporation books and papers. The work of assessment on the basis of these returns is generally intrusted to a specially constituted state board, by whom the valuation is determined, and in most cases apportioned among the local taxing districts for the computation and collection of the tax. Railroad real estate, not directly employed in traffic operations, is generally assessed and taxed by the local officials.

In about a third of the states the process of departure from the original general local property tax took the form of a series of substitutions for, rather than modifications of, the early method. In a number of states systems based on the various forms of capitalization were adopted. In 1880 considerable progress had already been made in this direction. In Connecticut, for instance, a plan providing for a tax based on valuation of corporate capital and floating and funded indebtedness came to be employed; in Maine, a tax based on market valuation of capital stock was adopted; and in New York, a scheme providing for railroad taxation in common with corporations generally, upon the basis of capital stock according to dividends, was established.

Since 1880, as regards railroad taxation, but little advance has been made in the introduction of these methods into new fields. Their most significant extension has been in the cases of the various other transportation companies, but these will be mentioned later.

One of the most serious obstacles to which plans of taxation based on capitalization have been exposed in the past has been the restriction which has been put upon the taxation of corporate bonded debt by a decision of the United States Supreme Court. In 1872 that body decided, in effect, that a state tax on that portion of a company's bonded indebtedness which is held by non-residents of that state would be considered unconstitutional.[1] It is a well-known fact that the bonded capitalization of the railroads of the country is about equal in amount to their capital stock; and that, therefore, a tax which rests in its immediate incidence merely upon the capital stock of a railway corporation reaches only a portion of the real investment. To this fact may probably be traced the origin of an influence, which has acted as a deterrent to the wider adoption of taxes based on capitalization.

In a comparatively recent Oregon case, however, the Supreme Court arrived at the decision that a tax levied within a state upon a foreign-held mortgage, which is secured by real estate situated within that state, is constitutional.[2] Should this doctrine be held to apply to corporate forms of mortgage indebtedness, a noteworthy change in the status of the tax on corporate capitalization would be effected. Such, at any rate, has been taken to be the implication of the decision by the committee of the present New York legislature, which has drafted a bill providing for the taxation of bonded or mortgaged debts; and the same view of the decision is held by other competent legal authorities.

Another method of railroad taxation, which was devised as a substitute for the original local property tax, was that of the tax on business receipts. Prior to 1880 taxes based on this principle had already been established in a number of states. Thus, for instance, Michigan, Minnesota, and Wisconsin had provided

[1] Foreign-held bonds case (15 Wall., 300).
[2] Savings Society *v.* Multnomah County (169 U. S., 421).

for graduated gross-receipts taxes. In Pennsylvania, too, a tax on gross receipts, in addition to the earlier general corporation tax on capital stock, was established; and in Delaware and Virginia a sort of net earnings tax was adopted to supplement the existing systems of those states. Since 1880 the gross-receipts tax has been subject to still further extension. For example, in 1881 Maine abandoned the tax on capital for one based on gross receipts; in the same year New York supplemented its existing system by a gross-receipts tax; and in 1882 Vermont, like Maine, provided for a gross-receipts tax. But in Vermont, as the result of constitutional exigencies, this system has since been made alternative with one based on property valuation. The former method, however, still prevails in practice. Since 1880 several other states, following the example set by Pennsylvania and New York, have provided for gross-receipts taxes, supplementary to previously existing systems.

But those cases in which taxes on receipts or earnings have been openly introduced into state tax systems, are not the only ones in which these methods are applied. In those states where the property valuation method prevails, the state boards whose duty it is to determine valuations, very often have considerable discretionary power. The tax laws which apply in these cases, frequently provide that these boards shall value railroad property with a view toward its earning capacity. In such instances, therefore, the possibility of arriving at a valuation which will bear an approximately constant relation to earning capacity, though only infrequently realized, yet exists. And still further, in those states where the franchise is valued in addition to property, earnings, as well as capital, are frequently considered in arriving at a valuation. The application and extension of such methods as these, are to be regarded as at least an indication of a drift of sentiment toward taxation based on railway earning capacity. That clause in the constitution of North Dakota, which explicitly recognizes the tax on gross-receipts as a method suited to railway taxation, must also be regarded as an indication of possibilities in this connection.

The stand that has been taken by the Supreme Court of the United States in the matter of the taxation of receipts from interstate traffic, however, has probably placed a serious impediment

in the way of a much wider extension of the gross-receipts method to railway taxation. In a series of litigations, the Supreme Court held that a state tax on gross receipts resulting from interstate traffic, except when levied as a franchise tax, is an interference with interstate commerce, and is therefore unconstitutional.[1]

Owing largely to the influence of these decisions, as well as to causes of a local nature, there appears to have set in within the last few years a tendency away from the gross-receipts tax in two states, which have in the past been the main strongholds of that method of taxation. In Wisconsin, and to a greater degree in Michigan, the existing systems have been subject to opposition. In the case of Wisconsin, the feeling in the matter is well voiced in the report of the Wisconsin Tax Commission of 1898. They say: "Most of the forms of tangible property are already taxed in full proportion to their value. In the case of banks, manufacturing and trading corporations, corporate property appears to be as heavily taxed as that of private individuals; but we do not think this is true of any class of corporations taxed on the basis of earnings or mileage basis." The commission, therefore, rather mildly advocate a change of method.

In Michigan the agitation against the gross-receipts tax has been very spirited. In 1897, and again in 1898, the railroad commission of the state, in its reports, arraigned the existing methods as unjust and ineffective, and voicing a quite general feeling in the matter, recommended in its stead the adoption of a tax based on the principle of property valuation. The governor of the state and other prominent men have been untiring in their efforts to bring about such a change. As a result, during the legislative session of 1897, the celebrated "Atkinson Bill" arose. It failed to pass that session, and was made the issue for a special session of the legislature of 1897. After various experiences it was passed by the legislature of 1899. This bill, which was largely modeled after the Indiana law, provided for a railway tax based on cash valuation of property and franchise, upon general lines similar to those which characterize that

[1] See Fargo *v.* Michigan, 121 U. S., 230, and Phila. & Southern S. S. Co., 122 U. S., 326. Also see Maine *v.* Grand Trunk Ry. Co., 142 U. S., 217, for *obiter* contrary to decision in other two cases.

system wherever it prevails. The law, however, was very short-lived; for the Supreme Court of Michigan, not long afterward, in two test cases,[1] declared it unconstitutional.

How much this agitation is the result of merely transitory political influences, and how far it is the outcome of strictly economic causes, it would be difficult to determine. Whatever may be the verdict on that question, it is quite evident that the political struggle against the gross-receipts system in that state has not yet spent its force; and though at present it is a matter of improbability, it ought not to be a matter of surprise, if a measure substantially the same as the "Atkinson Bill" were yet to find place upon the statute books of Michigan.[2]

The recent experience of Maryland has been quite the opposite of that in Michigan and Wisconsin; for under the new railway tax law of 1896, the gross-receipts tax of the state was very noticeably extended.

In connection with the taxation of transportation companies upon all of the bases that have been mentioned above, there has been rapidly spreading an administrative device for the prorating, according to mileage, of taxable elements of an interstate character. In the case of the tax on cash valuation of property, the necessity for the adoption of this plan arises, of course, only in the taxation of rolling stock. The plan generally followed in such cases is to tax rolling stock upon that portion of its value, which is represented by the proportion of mileage traversed within a state to total mileage covered.

Under the tax on capital, in the case of foreign corporations, the legal requirement that only that portion of the capital stock of any company which is employed within a state shall be taxed by that state, has resulted in the general adoption of the plan. The taxation of sleeping-car companies in Pennsylvania furnishes a good example of this practice. In that state, the capital stock of every such company is assessed by a state official, taking as the basis of assessment such proportion of the capital stock, as the number of miles of railroad over which the cars of the company are run in Pennsylvania bears to the mileage in that

[1] 78 Northwest Reporter, 125.

[2] Recently the constitution of the state was amended, and in 1901 a law taxing railroad property was enacted. [Note added by author in 1905.]

and other states over which its cars are run. The perfect legality of this method has been repeatedly affirmed by the United States courts.[1] In the case of domestic corporations, although the practice of pro-rating is not necessitated by legal dictum, recognition of the practical justice attainable under the method had led to its general adoption.

Under the gross-receipts tax, so far as concerns foreign corporations, any attempt by a state to tax receipts other than those resulting from purely intrastate traffic encounters a direct prohibition in the decisions of the United States Supreme Court. In the case of domestic corporations, the right of any state to measure the value of a franchise which it has granted by total receipts, even including those from interstate traffic, has been upheld by the courts. But the plan generally followed in such cases has been that of taxing only a mileage proportion of the gross receipts. Such, for example, is the method followed in Maine, where receipts from business of an interstate character are pro-rated according to the ratio which the mileage traversed in doing business within the state bears to the total mileage covered both within and without the state.

Other Transportation and Transmission Companies

One practice which is constantly becoming more and more prominent in the enacting of state tax laws, is that of making specific provision for the taxation of transmission and transportation companies other than railways. Of recent years, this has been particularly the case with those companies which do a business upon the various railway lines of the country, complementary and subsidiary to the railroad business. In legislating for the taxation of these companies, the states have very noticeably avoided the general property tax. It appears to have been quite generally recognized that a tax on the mere value of the property of these companies would be entirely ineffective in reaching their true taxable capacity. That this evil does actually arise under the property tax is amply affirmed by the experience of those states which still cling to that method. But changes are constantly being effected; and the general practice of recent

[1] See Pullman Car Company *v.* Pennsylvania (141 U. S., 18).

years has been manifestly pointing to the abandonment of the old system, and tending toward the adoption of others, which have already proved tolerably efficient in a number of the states.

In the case of express companies, the need for specific tax provision has been very marked. Under a local general property tax, these companies have almost entirely escaped taxation. The attorney-general of Montana not long ago made a statement bearing on this point, which is typical of the operation of this method wherever it exists. He says, "Take for instance one of the principal express companies operating in this state; in one county it undoubtedly does a business of several hundred thousand dollars, and the property owned by it in the county subject to taxation will not aggregate in value five thousand dollars. The system now prevalent, which ignores the franchise and simply assesses the tangible property, is practically a farce." Many states have sought to remedy this condition of things by specific legislation on the subject; and in most cases where this has been done, the gross-receipts tax has been adopted. Of quite recent years, however, the legislative trend appears to be toward a form of tax based on capital stock. Indiana adopted such a method in 1893, and Wisconsin adopted a similar plan within the past year. Ohio, several years ago, changed over from a gross-receipts tax to one nominally based on cash valuation of property, but in reality fixed very largely on the basis of net earnings. The practical difficulty of making adequate provision for the taxation of these companies, at least in the light of the various legislative efforts in the matter, is not a slight one. It will be interesting to note the experience of Texas, which is not far from typical in this respect.

The first law in that state upon the subject, enacted in 1879, in line with Southern tendencies, provided for a specific annual tax of $700 to be paid by every company doing business within the state. In 1882 the amount of the tax was reduced to $500. This law continued in force for seven years, when the amount of the tax was raised to $1000. This act was in turn repealed in 1895, when the present law, taxing these companies on the basis of their gross receipts, was enacted. The workings of this law appear thus far to have been attended with satisfactory results.

The taxation of sleeping, palace, and dining car companies, has claimed considerable attention during the past twenty years. In a number of states, a system of taxation based on cash valuation of rolling stock has been adopted. But in the majority of cases, where the taxation of these companies has been made the subject of specific legislation, the gross-receipts tax has been established. The tax on capital has also gained ground, as is shown by the enactment of the Indiana law of 1893, and the Wisconsin law of 1899. The experience of Texas in this matter, as in the case of express companies, is an interesting one. The first law on the subject, passed in April, 1879, provided for an annual tax of $2 per mile of road in the state over which cars were hauled. Three months later the plan was changed to one of a tax of one half of one per cent on the value of cars used in the state. In 1881 this law was repealed, and the law levying $2 per mile was reënacted. A year later, the tax was reduced to 50 cents per mile. All of these laws having proved unsatisfactory, the present law was passed in 1893. This, with the supplementary law of 1897, provides for a tax of one fourth of one per cent on the annual value of the gross receipts of the companies concerned, in addition to a tax of 25 cents on each $100 valuation of the capital stock employed within the state.

The problem of taxing fast-freight and car-line companies has come to be of considerable importance in recent years. In the framing of laws for the taxation of these companies, the tax on capital appears to have been the prevailing model. Such was the case with the recent Wisconsin law, as well as with the earlier Ohio law of 1896, and with the law passed in Minnesota in 1897, where all other transportation companies are taxed on the basis of gross receipts.

Upon the whole, the most marked tendency to be noted of recent years in legislation for the taxation of express companies, sleeping-car companies, and freight-line companies, has been one which points to the increasing adoption of the tax on capital. The Maryland law of 1893, which already had noteworthy precedents in the general corporation tax systems of Pennsylvania and New York, appears to have set an example which has been followed quite widely in the states northwest of the

Ohio River. The gross-receipts tax, largely as the result of federal interference, has of late been but little adopted.

The most notable practice among the states in the taxation of telegraph companies, has been one based on a cash valuation of telegraph line, determined on the principle of a fixed sum per mile of wire. This method and that of the taxation of gross receipts constitute the two methods which prevail in the majority of the states. With the telegraph companies, as with railroads, the decisions of the United States Supreme Court have been unfavorable to the taxation of interstate receipts.[1]

Legislation for the taxation of telephone companies has been upon the same lines as with telegraph companies, except that not infrequently as regards the former, instead of the method of the levy at a specific sum per mile of wire, the plan of a fixed tax per instrument in use has been followed. In a number of states, moreover, telephone companies have been made subject to taxes on gross receipts, where telegraph companies have been taxed on some other basis. This has been largely due to the fact that the telephone business is still mainly of a local character, with the result that a tax on the gross receipts of a telephone company, which are predominantly of an intrastate character, does not, as in the case of telegraph companies, encounter the limitations imposed by federal court decision.

Local Taxation

The problem of raising revenue for the ordinary expenses of local government is a difficult one. One of the most marked of present tendencies is a constant expansion of the sphere of local expenditure, which usually outstrips in rapidity the increase of state expenditure. The cause is quite obvious. The making of local improvements, such as paving and lighting, the growth of local charities, the opening of public parks, and the general improvement of local sanitary conditions, have all tended to create an increasing demand for local revenue. In the light of this fact, any change in the relation between state and local sources of revenue must be regarded as of particular interest and significance.

[1] See Telegraph Company *v.* Texas, 105 U. S., 460, and Ratterman *v.* Western Union Telegraph Company, 127 U. S., 411.

In the taxation of transportation companies, the main trend of legislation has been away from the local general property tax, toward a scheme of local taxation based on real estate only. It will be recalled that the property valuation method, which prevails in the majority of the states, in nearly every case provides for the local computation and collection of the state tax on the basis of values apportioned by a state board, and in most instances, in addition, for a local tax at the usual local rate upon the same apportioned values. This method must not be confused with the local general property tax pure and simple. In its administration at least, it is quite distinct; and in effect, it amounts to much the same thing as, for instance, the West Virginia method, by which the tax is entirely computed and collected by state authorities, with a subsequent distribution of a portion of the proceeds among the local districts. In reality, the only tax which in these cases remains exclusively subject to local control is the tax on railroad property, situated outside of the right of way; and this in actual practice applies only to real estate.

In a number of states, the complete separation of the sources of state and local railway tax revenues has already been effected. Upon the whole, this has been a practice of growing significance. But it has not been unattended with opposition, especially from the local districts, where it is urged that the removal of so large a source of revenue operates with injustice to the local divisions. There are many, too, who, for other reasons, regard the policy of separation as a dangerous innovation, especially should it apply to the taxation of corporations in general. In line with the attitude of the Maine Tax Commission of 1889, they deem it unwise "to sever the financial ligament which now closely unites the state government with the town, and in fact with every individual." Whether the policy is a wise one or not is still an open question. The practice of the states, at any rate, appears upon the whole to be pointing in that direction. Particularly in the case of railway taxation, the legislation of the past fifty years has tended to expand the taxing sphere of the more central authorities to the restriction of the sphere of local activity.

In several states, as in New Hampshire and West Virginia,

where railroad taxation is exclusively a matter of state administration, the plan of locally apportioning a share of the proceeds of the state tax in aid of local finances is in vogue. Although this practice is not at present of very great significance, in the event of the further general assumption of the functions of railroad tax administration by state authorities, its adoption, at least during transitional adjustments, might be expected as a matter of practical fiscal necessity.

In Minnesota railroad taxation is practically distinct from local activity. There, railroad property, excepting lands granted by the state or by the United States, is exempt from local taxation. But this is altogether exceptional, the preponderance of state practice being on the side of a local tax on railway real estate.

CHAPTER XVI

INHERITANCE TAXES IN THE UNITED STATES

62. The Development of Inheritance Taxes. — Solomon Huebner describes the development of inheritance taxes in American states, as follows:[1]

While most of the progressive nations of Europe have for many years used the inheritance tax extensively as a means of perfecting their systems of taxation, its development in the United States has taken place almost wholly within the last decade. The American commonwealths, in fact, have just emerged from the first stages of inheritance tax reform; for until about 1895 the legislation was confined almost exclusively to an extension of the tax to collateral heirs. Inasmuch, however, as twenty-four states, or over one half of the total number, have introduced the tax since 1890, and seven states almost simultaneously in 1901, the movement may now be said to have attained a distinctly national importance. The probable direction of this movement in the future constitutes an important question, which can be best answered by analyzing its past development. The successive stages of this development may be conveniently discussed under three periods, the first comprising the history of the tax from its adoption by Pennsylvania in 1826 to the year 1890, the second extending from 1890 to 1900, and the third comprising the legislation of the years 1901 and 1903.

(During the period from 1826 to 1890, Mr. Huebner shows that some of the states imposed light probate fees or taxes, and that a few imposed light taxes on collateral inheritances. Except in Pennsylvania and Maryland, all of the taxes established

[1] Reprinted, with consent of author, from the *Quarterly Journal of Economics*, August, 1904.

prior to 1885 were abandoned for various reasons. In 1885 New York established a 5 per cent tax on collateral inheritances, which soon began to yield considerable revenue and was subsequently a model for taxes introduced in other states. Thus at the close of this first period the inheritance tax was used by only a few of the Eastern states.)

Legislation from 1890 to 1900

The period between 1890 and 1900 was one of rapid growth. With the exception of 1890 and 1898 every year saw new states added to the list, and by the close of the decade eighteen new taxes were in operation. Associated with this rapid increase in the number of taxes there was also a strong disposition to improve the tax itself. Two new tendencies appeared prominently for the first time; namely, the introduction of progressive rates and the extension of the tax to direct as well as collateral relatives. In accordance with these tendencies ten states supplemented their collateral inheritance taxes with taxes on direct heirs. Schemes for the adoption of progressive rates were also constantly brought forward, and several radical measures succeeded in passing the lower branches of the legislatures.

A considerable number of the new taxes still applied only to collateral heirs. Of the twenty-one states establishing such laws during this period, over one half applied the tax exclusively to collateral heirs.[1] In all of these states the original rate was 5 per cent, except in Louisiana, Maine, North Carolina, and Ohio, where the rates were 10 per cent, $2\frac{1}{2}$ per cent, $1\frac{1}{2}$ per cent, and $3\frac{1}{2}$ per cent respectively. Before the close of the decade, however, the acts of Louisiana and North Carolina were abolished; while in Ohio, Maine, and Connecticut the rates were changed to 5, 4, and 3 per cent respectively, thus placing the rate at 5 per cent in all of these states except Maine and Connecticut.

[1] Massachusetts, Laws of 1891, ch. 425; Tennessee, Acts of 1893, ch. 174, p. 347; New Jersey, Acts of 1892, ch. 122; Acts of 1894, ch. 210; Ohio, Laws of 1893, p. 193; Maine, Laws of 1893, ch. 146, p. 168; California, Laws of 1893, ch. 168, p. 193; Vermont, Laws of 1896, No. 46, p. 38; Virginia, Laws of 1895–96, p. 367; Iowa, Laws of 1896, ch. 28, p. 35; Missouri, Laws of 1899, p. 328; Louisiana, Laws of 1894, No. 130, p. 165. This act applied only to foreign heirs.

The original property exemption was $500 in all cases except Massachusetts, Ohio, Wisconsin, Minnesota, Vermont, Iowa, North Carolina, Tennessee, and Virginia, the first two states exempting $10,000, Wisconsin and Minnesota exempting $10,000 and $5000 respectively on personal property, Tennessee $250, Vermont and Iowa $2000 and $1000, while North Carolina and Virginia subjected the entire estate to the tax. The Wisconsin and Minnesota laws, however, were nullified by the courts; North Carolina repealed its law in 1899; while Massachusetts and Ohio changed their $10,000 exemption to $500 and $200, thus leaving the property exemption for collateral relatives at $500 in all of these states except five. In this connection it should also be said that there existed a marked tendency to exempt bequests for charitable, educational, religious, or purely public purposes. This policy began in New York and Connecticut in the previous period, and was extended to ten states in this period, — Iowa, Massachusetts, Montana, Vermont, California, Illinois, Maine, New Jersey, Ohio, and Virginia. Of these ten states only the first four provided for such exemptions in their original laws, all the remaining states adopting the policy by subsequent acts. Moreover, Louisiana, California, and Missouri provided that the entire proceeds of the tax should be applied to specific purposes, and not to the general expenses of the state. Louisiana devoted the proceeds to charitable purposes, California applied the tax to the general school fund, and Missouri appropriated it for higher education.

Lastly, we must notice the two tendencies which particularly distinguish this period from the former one; namely, the marked effort to introduce a progressive rate and to apply the tax to direct heirs.

(Mr. Huebner then discusses certain unsuccessful attempts made in the legislatures of five states to introduce progressive rates.)

Of the successful attempts at direct or progressive taxation, New York afforded the first instance in 1891 by supplementing its collateral tax with a tax on direct heirs, and was followed in 1893 by the direct tax of Michigan. In 1894 followed the

direct and progressive tax of Ohio, in 1895 the progressive collateral tax of Missouri, and in 1896 the direct and progressive tax of Illinois. In 1897 direct taxes were adopted in five states, — namely, Minnesota, Montana, North Carolina, Connecticut, and Pennsylvania; and these were followed in 1899 by the direct taxes of Michigan and Wisconsin.

An examination of these taxes on direct heirs shows that Connecticut, Illinois, North Carolina, and Ohio were the only states in which the tax applied to real as well as personal property, the direct taxes of Michigan, Pennsylvania, Montana, Minnesota, New York, and Wisconsin applying only to personal property exceeding $5000 in the first two states, $7500 in the third state, and $10,000 in the last three. In all of these last-mentioned six states the rate was but 1 per cent except in Pennsylvania, where the rate was 2 per cent. Though applied both to realty and personalty in only four states, the importance of these taxes was minimized in Connecticut and North Carolina by the low rate of one half of 1 per cent, and two thirds of 1 per cent respectively, and in Ohio and Illinois by the large exemption of $20,000. It may thus be said that none of the ten states introducing taxes on direct heirs during this period adopted what might be called a normal tax, the rate being either very low, the exemption very large, or the tax applying only to personal property. Before the end of March, 1901, the direct taxes of four of these states — Minnesota, Ohio, Pennsylvania, and Wisconsin — were declared unconstitutional,[1] while North Carolina repealed its law in 1899, thus leaving in force as the result of the legislation of this period the direct taxes of New York, Michigan, Illinois, Montana, and Connecticut.

[1] Minnesota: *Lincoln Drew* v. *M. C. Tift*, 79 Minn., 175. The law was declared unconstitutional chiefly because it applied only to personal property, because it granted a larger exemption to lineal than to collateral heirs, and because it applied to the estate as a whole, and not to the excess above the exemption.

Ohio: *State of Ohio ex. rel.* v. *Ferris*, 53 Ohio, 315. The progressive rate, and the exemption of estates exceeding $20,000 from taxation, while taxing the whole estate if it exceeded that sum, were held to conflict with that portion of the Bill of Rights which declares that "all political power is inherent in the people. Government is instituted for their equal protection and benefit."

Pennsylvania: Estate of *J. F. Portuondo, deceased, Appeal of the Commonwealth of Pennsylvania*, 191 Pa., 28. The law was declared unconstitutional because it changed the law of descent or succession, granted exemptions other than those permitted by

Illinois, Ohio, and Missouri were the only three states which succeeded in passing progressive taxes. In Ohio the rate rose from 1 per cent on estates valued between $20,000 and $50,000 to 5 per cent on estates exceeding $1,000,000, but did not apply to estates passing collaterally. Missouri, on the other hand, applied the progressive rate, ranging from 5 per cent on estates of $1000 or less to $7\frac{1}{2}$ per cent on the excess above $10,000, only to estates passing to collateral heirs. In Illinois,[1] as in Missouri, the graduated rate applied only to collateral relatives and strangers in blood, though Illinois distinguished three classes of heirs through a difference in the property exemptions. Soon after their passage the taxes of Ohio and Missouri were declared unconstitutional, and the Illinois law thus remained alone among the numerous acts of this period in recognizing three classes of heirs and in applying a progressive rate to estates passing collaterally.

Legislation since 1900

The close of the decade thus left very much to be desired. Ten states had applied the tax to direct heirs, and Illinois had indeed adopted a progressive scale; but there was as yet no state which applied the progressive principle to direct heirs, the tax of Ohio having been declared unconstitutional, and the proposed progressive taxes of Massachusetts, New York, and

the constitution, and imposed a tax which was not uniform upon the same class of subjects.

Wisconsin: *Black* v. *State*, 113 Wis., 205. The law was declared unconstitutional because it imposed a tax which was considered unjust and discriminatory between heirs of the same class.

[1] The Illinois law of 1895 proved to be of such importance as a model for later laws that its contents deserve to be stated at length. The law imposed the following rates:

1. 1 per cent on the excess above $20,000 received by each of the following heirs: father, mother, husband, wife, child, brother, sister, wife or widow of the son, or husband of the daughter, adopted and mutually acknowledged children, or any lineal descendants.

2. 2 per cent on the excess above $2000 received by each of the following heirs: uncle, aunt, niece, nephew, or their lineal descendants.

3. In all other cases (estates of $500 being exempt): 3 per cent when estate is valued between $500 and $10,000; 4 per cent when estate is valued between $10,000 and $20,000; 5 per cent when estate is valued between $20,000 and $50,000; 6 per cent when estate is valued at more than $50,000.

Pennsylvania having merely passed the popular branch of the legislature. In the years 1901 and 1903, however, we witness the introduction of the tax in eleven states,[1] and see in these taxes a decided advance over previous legislation.

The chief interest in these taxes lies in their rates, the great diversity of which does not permit of generalization. Utah levied a uniform tax of 5 per cent on all estates exceeding $10,000, without discriminating between classes of heirs. Arkansas levied a rate of 5 per cent upon all estates passing to collateral heirs, without granting any exemption; while Minnesota imposed a rate of 5 per cent upon estates passing to collateral heirs, and a rate of 1 per cent upon direct heirs, granting in either case an exemption of $5000. Colorado and Nebraska modeled their progressive taxes upon the Illinois law, except that Nebraska applied the direct tax only to the excess above $10,000, while Colorado imposed a rate of 2 per cent on estates exceeding $5000 passing to direct heirs and a rate of 3 per cent on estates exceeding $2000 passing to the decedent's uncle, aunt, niece, nephew, and their lineal descendants. North Carolina followed very closely the form of the national tax of 1898,[2] while Washington, in addition to a direct tax of 1 per cent on sums valued above $10,000, applied an elaborate schedule of rates to estates passing collaterally.

(The author then discusses the constitutionality of the Minnesota act of 1901, which was declared by the courts to be invalid. Another inheritance tax, enacted in 1902, was also declared unconstitutional, since it also exceeded the rate of 5 per cent prescribed by the constitution.)

Turning now to the legislation of 1903, we find that five new acts were added to the list; namely, those of North Dakota,

[1] Arkansas, Acts of 1901, ch. 156, p. 295; Colorado, Laws of 1901, ch. 94. sect. 23, p. 247; Minnesota, General Laws of 1901, ch. 255, p. 402; Nebraska, General Laws of 1901, ch. 54, p. 414; North Carolina, "Revenue Act," Session 1901, p. 58; Utah, Laws of 1901, ch. 62, p. 61; Washington, Laws of 1901, ch. 55, p. 67; North Dakota, Laws of 1903, ch. 171; Wyoming, Laws of 1903, ch. 80; Oregon, Laws of 1903, February 16, 1903; Wisconsin, Laws of 1903, ch. 44.

[2] In 1898 the federal government levied a tax upon inheritances of personal property in excess of $10,000. This tax was subsequently repealed. — ED.

New York, Oregon, Wyoming, and Wisconsin. Of these five states, North Dakota was the only one to adopt merely a collateral tax, which, in striking contrast to the legislation since 1900, imposed the low rate of 2 per cent on estates valued above $25,000. Wyoming, on the contrary, levies a rate of 5 per cent on all property exceeding $500 in value and descending to collateral relatives, and a rate of 2 per cent on property exceeding $10,000 in value transferred to direct heirs. New York extended its succession tax of 1 per cent on personal property to the transfer of real estate to near relatives and lineals when the aggregate amount of the estate is $10,000 or more. Oregon modeled its tax closely upon the Illinois law, except that the exemption for direct heirs extends only to estates valued at $10,000 or less, while the rate applies only to the excess above $5000 received by each person.

But in sharp contrast to the general legislation of 1903, and as representing a wide departure from any previous state inheritance tax law, stands the Wisconsin Act of March 27, 1903. This act may be said to have been the direct result of the state Supreme Court decision of 1902, which nullified the act of 1899 on the ground that the $10,000 exemption of that act in applying to the estate as a whole, and not to the share received by each heir, constituted "arbitrary discrimination, and not classification."[1] . . .

To avoid the discrimination thus set forth by the court, the legislature enacted a law which deducts the exemption from each individual share, and taxes only the remainder. The act, moreover, computes the tax on the fractional part comprised within each of a number of property classifications, the total tax on each individual share being the sum of the various items. The following is the progressive schedule of this tax:

[1] The court said: "Thus it results that one collateral relative, receiving a legacy of $2000 from one testator, whose estate amounts to but $9500, pays no tax, while another collateral relative in the same degree, receiving a legacy of $2000 from another testator whose estate amounts to $10,500 is obliged to pay a tax. Here is unlawful discrimination, pure and simple. No rational distinction or difference can be drawn between the two legatees simply because the estates from which their legacies came are of slightly different size. They are both within the same class, surrounded by the same conditions, and receiving the same benefits. One pays a tax, and the other does not. This is not the equal protection of the laws." — ED.

THE INHERITANCE TAX IN WISCONSIN

Indication of Relationship	Property Exemption	Rates Applicable to the Fractional Part between				
		On excess after deduction of exemption from $25,000	$25,000 to $50,000	$50,000 to $100,000	$100,000 to $500,000	Excess above $500,000
		Per cent	Per cent	Per cent	Per cent	Per cent
Husband, wife, lineal issue, lineal ancestor, adopted or mutually acknowledged child	Widow, $10,000 others, $2000	1	1½	2	2½	3
Brothers, sisters, and their descendants, wife or widow of a son or husband of a daughter	500	1½	2¼	3	3¾	4½
Uncles, aunts, and their descendants	250	3	4½	6	7½	9
Brothers or sisters of the grandfather or grandmother, or their descendants	150	4		8	10	12
Persons in other degrees of collateral consanguinity, strangers, and corporations not exempt	100	5	7½	10	12½	15

Summary

Having passed in review the most important steps in the growth of the inheritance tax in the American commonwealths, we are now in a position to summarize the general results. During the three quarters of a century following the Pennsylvania tax of 1826, we have traced a development from small beginnings to a system comprising thirty states in the extent of its application, and which in a few instances is beginning to resemble some of the highly developed taxes in foreign countries. In the period preceding 1890 no general advance is discernible, and in the decade between 1875 and 1885 inheritance tax legislation was practically suspended. Applied only to collateral heirs or levied merely in the form of a fee and introduced at

widely separated intervals, the taxes of this period show a lack of scientific structure, and a tendency to become inoperative by being omitted from the annual revenue acts or by being declared unconstitutional. Our chief interest in this period lies in the fact that certain taxes, like those of Pennsylvania and New York, were to be used as models by other states. In the following period our interest centers primarily in the New York direct tax of 1891 and the Illinois direct and progressive tax of 1895, both of which were to be used in turn as improved models for later acts. Subsequent to 1900 our interest centers chiefly in the Wisconsin tax of 1903, which far surpasses any earlier law in the scientific character of its provisions.

As might be expected, the existing laws still leave much to be desired. Sixteen, or over one half, of the taxes still apply only to collateral heirs; yet foreign experience indorses a tax on direct heirs as desirable. While progression has obtained a permanent place in most of the important foreign taxes, its adoption in this country is limited to seven states. Undesirable provisions also exist in eight other states, Illinois exempting $20,000 of the property passing to each direct heir, Minnesota and Connecticut granting an exemption of $10,000 to strangers in blood as well as to direct heirs, Michigan, Montana, and North Carolina extending their direct taxes only to personal property, and Utah taxing all heirs alike at a uniform rate of 5 per cent and with a uniform exemption of $10,000. To these states may be added North Dakota, Maryland, and West Virginia, which, while taxing only collateral relatives, impose a rate of 2 per cent and 2½ per cent. The constitution of Minnesota, furthermore, limits the progression to a maximum rate of 5 per cent. Alabama, according to her constitution, is only permitted to adopt a tax on collateral heirs with a rate not exceeding 2½ per cent; while in Louisiana the constitution limits the tax to 3 per cent for direct heirs and 10 per cent for collateral heirs, specifying, however, that these rates can be imposed only on such personal property as has escaped its burden of taxation.

Yet undesirable as some of these constitutional restraints and statutory provisions may seem, we cannot help observing progress in many directions. Most of the states have adopted similar rates and property exemptions in their collateral taxes.

Fourteen, or nearly one half of the states taxing inheritances, have also applied the tax to direct heirs; and of these taxes all were passed since 1890, all but two since 1896, and nine since 1900.

As previously shown, six of the taxes on direct heirs passed before 1900 applied only to personal property; and, of the remaining four states possessing such a tax, Connecticut and North Carolina levied exceedingly low rates, while Illinois and Ohio granted exceedingly large exemptions. Strikingly different is the situation afforded by the legislation of 1901 and 1903. Of the eleven taxes introduced in these two years, all but two applied to direct heirs and all but four contained progressive rates. If analyzed, these taxes will show a distinct advance over previous legislation, — an advance which becomes apparent if one observes the following changes:

1. The progressive principle has been resorted to more extensively. The Illinois law, standing alone among the taxes passed prior to 1901 in distinguishing three classes of heirs and in possessing a progressive rate, was followed by Colorado, Nebraska, and Oregon. Washington, though applying the progressive principle only to collateral relatives, extended it further than did Illinois; and North Carolina in 1901 for the first time distinguished five classes of heirs, and applied the progressive rate to direct as well as collateral relatives.[1] The Wisconsin law of March 27, 1903, however, stands out as the landmark of this period. For the first time was a law passed in the United States which recognizes five classes of heirs, which grants a separate exemption to each one of these classes, and which imposes a progressive rate graduated according to the amount of all property above the specified exemption received by each beneficiary.

2. The rates are higher than in the preceding period. At the close of the century the maximum rate for direct heirs was 1 per cent and for collateral heirs 6 per cent. Subsequent to 1900 the rate was raised to a maximum of 5 per cent for direct and 15 per cent for collateral relatives. Wyoming and Colorado impose a rate of 2 per cent upon all estates passing to immediate

[1] By the Revenue Act of 1903 the progressive rate in North Carolina was retained only on estates passing to remote relatives and strangers in blood.

relatives; and Utah levies a direct tax of 5 per cent, — a rate which, in view of the fact that the great majority of estates pass between immediate relatives, makes this tax the heaviest in the country at the present time. Wisconsin for the first time increased the rate on all property above the specified exemption from 3 per cent in the case of immediate relatives to 4 per cent in the case of brothers and sisters and their descendants, to 9 per cent in the case of uncles, aunts, and their descendants, and to 15 per cent in the case of remote relatives or strangers.

3. The property exemptions granted to direct heirs are lower than in the preceding period. Of the existing taxes passed prior to 1901 Michigan was the only state with an exemption of $5000 for direct heirs. To-day, however, Wisconsin, though exempting estates of $10,000 passing to the widow, grants an exemption of only $2000 to the husband, lineal issue, lineal ancestors, and adopted children, $500 to brothers and sisters and their descendants, and only $250 to uncles, aunts, and their descendants. In Colorado, Nebraska, and Washington the exemption, instead of being $20,000 as in the Illinois law of 1895, is placed at $5000 in the first state and $10,000 in the last two. The Oregon act, likewise modeled upon the Illinois law, exempts estates of $10,000 or less, and specifies that the tax shall apply only to the excess above $5000 received by each person.

4. Instead of three fifths of the taxes on direct heirs applying only to personal property, as was the case prior to 1900, all of the nine states introducing a direct tax since that year, except North Carolina, have applied it to both personalty and realty. Particularly significant, too, from a fiscal standpoint, is the extension in 1903 of the New York succession tax to transfers of real estate.

63. The Financial Significance of Inheritance Taxes.—Professor H. A. Millis has gathered the following facts concerning the present financial results of American taxes on inheritances:[1]

[1] Reprinted, with the consent of the author, from the *Quarterly Journal of Economics*. February, 1905.

Inheritance taxes are now being collected in thirty of our commonwealths. In but one state — Alabama — has an inheritance tax, once legally collected, been abolished and not reintroduced. Laws enacted in New Hampshire and Minnesota have been held to be unconstitutional. In fifteen of the thirty states referred to only the shares of collateral heirs and strangers in blood are taxed. In the other fifteen the shares of "direct" heirs are taxed as well, but usually at much lower rates.

Since Mr. Huebner completed his study, two states have enacted new laws, Ohio imposing a tax on "direct" heirs and Louisiana a tax on estates which have not borne their "just proportion of taxes."

* * * * * * *

Turning to the financial significance of the inheritance tax, Mr. Huebner has shown that the aggregate of revenues derived from it by the several states has grown rapidly since 1885.[1] Yet an examination of the returns for the several states shows that the yield is in but few instances large. In Table I will be found a fairly complete statement of the revenue derived from this tax by the several states since 1885. Leaving out of consideration Wisconsin and Ohio, where because of recent legislation the normal yield is as yet unknown, in only ten states does it exceed $100,000.[2] In but two of these, New York and Pennsylvania, does the revenue exceed a million dollars per year; and in only two other states, Massachusetts and Illinois, does it approach five hundred thousand dollars.

But such general statements mean little. In Table II will be found a statement of the average revenues *per capita* and the percentage these form of the total revenues of most of the commonwealths for a period of years. The largest *per capita* revenue is found in New York, where for the three years 1901–03 it was on the average 48.73 cents. In but seven of the

[1] The following table shows the total revenue derived from state inheritance taxes for the years indicated:

1885	$944,335	1900	$7,421,645
1890	1,886,509	1901	7,591,438
1895	4,016,841		

[2] Massachusetts, Connecticut, New York, New Jersey, Pennsylvania, Illinois, Michigan, Iowa, Missouri, and California.

other states noted did it yield as much as ten cents *per capita*, while in six states it produced less than five. New York during this period obtained about 12 per cent of her state revenue from this source. Three other states obtained more than 5, the others less than 5 per cent of their revenues from inheritance taxes.

A comparison of the returns from our taxes on successions with those of some foreign countries still further emphasizes the low productivity of the former. Table III shows the fiscal importance of the taxes on gifts and successions, and the *per capita* revenue derived therefrom in Great Britain, France, and some of the Australian states and Canadian provinces. Comparison between Tables II and III shows the *per capita* revenues to be much larger in Great Britain, France, Victoria, and South Australia than in any American state. The great differences are not explained by differences in the amount of wealth and in the amount transferred by will or otherwise. Most of the differences in *per capita* wealth are slightly in our favor. The explanation is found in the more drastic character of the inheritance tax legislation and the superior administration in the foreign countries.

In Great Britain there are a number of "death duties." The most important of these is the "estate duty" levied upon the market value of all property, real or personal, whether succeeded to by direct or other heirs, estates worth less than £100 being exempted. The rates are progressive, varying from 1 per cent for the first class (£100 to £500) to 8 per cent for the twelfth class (£1,000,000 or over). To this is added a "settlement estate duty" of 1 per cent on "settled property." Estates exceeding £1000 pay, in addition to the estate duty, a legacy duty upon personal property and a succession duty upon real estate going to collateral heirs and strangers in blood. In effect these two taxes constitute an additional collateral inheritance tax falling upon heirs other than lineal issue and ancestors. The collateral heirs are divided into four classes; and the rates are 3, 5, 6, or 10 per cent, according to the degree of relationship.

In France, as the law was amended in 1901 and 1902, estates of 1000 francs and over are taxed according to the relationship of the heir and the net value of the property received by him.

Heirs are divided in seven classes, and the rates vary both with the amount of the inheritance and the degree of relationship. Thus on shares of from 1000 to 2000 francs they range from 1 per cent for descendants to 15 per cent for remote relatives and strangers in blood. The shares are classified according to size, — there being twelve classes in all, — and the rates caused to progress to 5 per cent for descendants and 20½ per cent for remote relatives and strangers in blood.

In Victoria estates below £1000 are now taxed, and those between £1000 and £5000 are taxed on the excess over £1000. Estates are divided into thirty-eight classes, the last consisting of those exceeding £100,000. The rates progress from 2 per cent on the first class (£1000 to £5000) to 10 per cent on the last class. The widow, children, and grandchildren of the deceased pay one half of the above rates. This amounts to a progressive direct inheritance tax of from 1 to 5 per cent, and a collateral tax of from 1 to 10 per cent, with an exemption of £1000 and a deduction of a like amount from estates below £5000.

In South Australia heirs are divided into three classes. The surviving husband or wife and lineal descendants and ancestors pay rates varying from 1½ per cent on shares of from £500 to £700 to 10 per cent on shares of £200,000 and upward. Collateral heirs pay rates varying from 1 per cent on shares under £200 to 10 per cent on shares of £20,000 and upward. Strangers in blood pay a uniform rate of 10 per cent.

By comparing these laws with those of our American states, we can readily account for most of the differences in revenue produced. In all four of these instances direct as well as collateral heirs are taxed. In half of the American commonwealths using the tax it is limited to collateral heirs and strangers in blood. By far the greater part of property descends to direct heirs. Taxes on direct heirs at low rates are more productive than taxes on collateral heirs at higher rates. Unfortunately, it has been possible to separate the taxes paid by the two classes of heirs in the state of New York alone. In that state a direct inheritance tax of 1 per cent on *personal* estates in excess of $10,000 has yielded from one third to more than three fourths as much revenue as a collateral inheritance tax of

5 per cent on both real and personal estates in excess of $500.[1] The successions and donations to lineal relatives and husbands and wives in France in 1896 aggregated 5132 million, to others 1327 million francs.

* * * * * * *

Again, in many of our commonwealths the classifications of heirs are very much more liberal than in these four foreign countries, where the taxes are more productive. In Great Britain only the surviving husband or wife, lineal issue, and ancestors are exempted from the legacy and succession duties; in South Australia these, and in Victoria widows, children, and grandchildren, pay the lower rates; while in France at present the lowest rates are extended to descendants alone. An examination of the American laws shows that in nine[2] states "direct heirs" are surviving husband or wife, lineal issue, and ancestors only; in two,[3] these and sons and daughters in law; in two,[4] these and brothers and sisters; in twelve,[5] these and both brothers and sisters and sons and daughters in law; while in two more[6] the class is even more elastic.

The relatively small revenue in a few of our states is explained in part by the fact that only personal property is taxed. This is true of the tax in its entirety in North Carolina, and of the direct taxes in Michigan and Montana.[7]

The small yield of our taxes is explained in part by the

[1] The following statistics are typical of the revenue in New York:

Year	Revenue from Direct Tax	Revenue from Collateral Tax
1896	$776,195	$1,265,978
1897	941,119	1,227,017
1902	878,297	2,425,258

[2] Arkansas, Connecticut, Iowa, Maryland, Missouri, North Dakota, Pennsylvania, Washington, and West Virginia.

[3] Maine and Vermont.

[4] North Carolina and Virginia.

[5] California, Colorado, Illinois, Massachusetts, Michigan, Montana, Nebraska, New Jersey, New York, Oregon, Tennessee, and Wyoming.

[6] Delaware (tax applies to strangers in blood only) and Ohio.

[7] Most of the laws which formerly applied to personal property only have been declared unconstitutional, or, as in New York (in 1903), have been amended.

further fact that many of the exemptions are comparatively large. As a rule, this is not true of the exemptions accorded collateral heirs. However, in North Carolina collateral heirs are not taxed on estates below $2000; in Massachusetts, $10,000; in North Dakota, $25,000. In Connecticut and Utah a uniform exemption is fixed for both classes of heirs, the amount being $10,000.[1] The exemptions accorded direct heirs in this country are comparatively large. In Great Britain it is £100; in France, 1000 francs; in South Australia, £500; in Victoria, £1000. Direct heirs in the majority of the American commonwealths, on the other hand, are taxed on the excess of estate or share over $10,000 or those under $10,000 are not taxed. In Michigan only the shares of personal property over $25,000 are taxed; in Illinois, the excess of the share over $20,000. In Ohio the heirs are taxed on the excess of their shares over $3000; in Oregon, $5000; in Montana, $7500; in North Carolina, $2000, — the tax being collected in the last two mentioned states upon personal property only.

The net result of the non-taxation of direct heirs in half of the states, of making the class of direct heirs very inclusive, of discriminating in favor of real estate, and of the numerous large exemptions, has been to limit the inheritance tax to a comparatively few estates.[2]

A further examination of the American laws will show that the rate of the tax on successions is in many instances comparatively low. In Great Britain the rates for direct heirs are graduated from 1 to 8 (or even 9) per cent; in France and in Victoria, from 1 to 5 per cent; in South Australia, from $1\frac{1}{2}$ to

[1] The last Massachusetts Tax Commission found that an exemption of estates not exceeding $10,000 would reduce the taxable principal almost 20 per cent. See Report of the Commission on Taxation, 1897, p. 98.

[2] The number of taxable estates in New York for some years has been:

1895	2,682	1900	2,818
1896	2,624	1901	3,059
1897	2,556	1902	3,277
1899	2,721	1903	3,769

The number of taxable estates in Iowa in 1902 was 319; in Montana for the four years 1898 to 1902, 96. This is about one taxable estate per year to each 2400 persons in New York, one to 7000 in Iowa, and one to 10,130 in Montana. In Great Britain the number of taxable estates in 1900 was 67,338, or one to each 620 of the population.

10 per cent. Among the American commonwealths Wisconsin alone makes use of graduated rates for direct heirs. They are from 1 per cent on the first $25,000 to 3 per cent on the excess over $500,000.[1] Of the other fourteen states collecting direct inheritance taxes, seven[2] have the rate of 1 per cent, three[3] 2 per cent, Louisiana 3 per cent, Utah 5 per cent, North Carolina three quarters of 1 per cent, and Connecticut one half of 1 per cent. These low uniform rates, with the large exemptions noted above, should not bear heavily upon the widows and orphans.

When we turn to the other heirs, we find they are required to pay progressive rates varying from 1 to 19 per cent in Great Britain, $3\frac{3}{4}$ to $20\frac{1}{2}$ in France, 2 to 10 in Victoria, and from 1 to 10 per cent in South Australia. Twenty-three of our commonwealths have uniform rates for collateral heirs and strangers in blood. The rate of 5 per cent obtains in eighteen of these.[4] In North Dakota the rate is 2 per cent, in Maryland and West Virginia $2\frac{1}{2}$ per cent, in Maine 4 per cent, and in Louisiana 10 per cent. Seven states make use of graduated rates, five for remote relatives and strangers in blood only, two for less remote relatives as well. In Illinois, Nebraska, and Oregon, uncles, aunts, nephews, and nieces, and their descendants, pay 2 per cent; in Colorado, 3 per cent. A third class of heirs pay rates graduated from 3 to 6 per cent. In North Carolina three classes of collateral heirs pay $1\frac{1}{2}$, 3, and 4 per cent. Distant relatives and strangers in blood pay graduated rates of from 5 to 15 per cent, the tax resting on personal property only. Collateral heirs in Washington pay graduated rates of 3, $4\frac{1}{2}$, and 6 per cent, more distant relatives and strangers in blood twice as much. And, finally, in Wisconsin the rates for other than direct heirs vary from $1\frac{1}{2}$ to 15 per cent.

From this comparison it is seen that the direct inheritance tax rates in this country are comparatively low, the collateral inheritance tax rates fairly high, except on the largest estates, when

[1] The rates are applied to the fractional part of the given estate falling within each class.

[2] Illinois, Michigan, Montana, Nebraska, New York, Oregon, and Washington.

[3] Ohio, Wyoming, and Colorado.

[4] Arkansas, California, Connecticut, Delaware, Iowa, Massachusetts, Michigan, Missouri, Montana, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Utah, Vermont, Virginia, and Wyoming.

graduated rates are not used, and in those instances where the exemptions are very large.

A few words may be added concerning the proper place of the inheritance tax in the tax systems of our commonwealths. How much revenue should be obtained from this source must be determined in the light of the fiscal needs of the state and the comparative goodness of the tax. The fiscal needs of the states are great. At present any movement toward radical reform of the tax system by abolishing the general property tax and separating the sources of state and local revenue is held in check in most of our commonwealths by the difficulties involved in getting suitable sources of state revenue. The fiscal needs in almost all instances are such that a large revenue should be drawn from this source if it can be done with a fair degree of justice and without working injury.

The inheritance tax has most of the marks of a good tax. Experience shows that it can be made to yield a large revenue. This is collected at small expense. The problems of administration are comparatively simple, and evasion comparatively difficult. Absence of shifting makes it possible to place the burden where it is desired that it should rest. It is possible to arrange the details so as to make the tax equitable, as taxes go. Its tendency to suppress and to destroy the basis upon which it is levied is comparatively slight, at any rate if the burden placed on near relatives is not great. In other words, though the tax rests upon accumulated wealth, it does not necessarily discourage accumulation to any great extent. It is conveniently paid in the vast majority of instances. And, finally, though it should not be changed frequently to obtain more or less revenue as needed, it is a fairly reliable source of income. It is true that in many instances the yield has varied greatly from year to year; but, as the tax becomes more general in its application, this irregularity tends to disappear. The inheritance tax is thus a good tax from the fiscal point of view. It also has possibilities for controlling the distribution of wealth, though the advisability of using it to any great extent for this purpose is doubtful.

The revenue from the inheritance tax being greatly needed, and the tax a desirable one, how should the laws be shaped,

constitutional limitations aside, so as to obtain the proper amount of revenue from this source?

From the point of view of the taxpayer, upon whom the burden of the tax rests, real estate (assuming due time for the collection of taxes) adds to his ability to contribute to the support of government, and is in the same sense an unearned income, as is personal property. The tax should be levied upon real estate as well as upon personal property, though in some instances there may be good reason for placing a higher rate upon the latter because it is prone to evade taxation under the general property tax.

All heirs who are placed in better position to contribute to the support of the state should be taxed. The heirs not dependent upon the deceased have greatly increased ability because of the accidental and fortuitous character of the income, and because it is not, as a rule, in any way a return for time and effort spent. Heirs other than surviving wife or husband and lineal issue and ancestors are usually not in a dependent or a contributory relation to the deceased, and therefore should be taxed on that to which they succeed. In many instances the surviving husband or wife, issue, and ancestors likewise profit by the decease and succession; and the property is to no great extent the product of their effort. They have taxpaying ability which should be reached. On the other hand, there are numerous instances in which this is not true. But, inasmuch as the revenue is needed, and the state cannot deal with individuals in such matters, except as members of a class, it seems best to tax all direct heirs. The tax should be general, resting upon direct as well as upon collateral heirs and strangers in blood.

But it is clear from what has been said that good reason exists for classifying heirs and favoring some as against others. That is, some have contributed to the upbuilding of the estate inherited or are dependent upon the deceased: others have not contributed, and are not dependent. By discriminating between surviving husband or wife, lineal issue and ancestors, on the one hand, and all other heirs on the other, a fairly just line is drawn. In the majority of our commonwealths the favored class of heirs should be contracted. Whether a distinction should be made between certain collateral relatives and more

remote relatives and strangers in blood, as some of our states do, is a question. An intermediate class for brothers and sisters, and uncles and aunts, and their descendants, may serve to prevent their being placed in the class of "direct heirs"; but it is difficult to show that as a class they are much less able to pay taxes on their shares than are the other heirs, and such discrimination adds to the difficulties of administration and diminishes the productivity of the tax. On the whole, it may be well to provide such an intermediate class; for it will prevent the working of hardship in some cases. But the twofold and threefold classifications of heirs which generally obtain in this country are to be preferred to those more refined classifications now frequently met with. The provision of numerous classes is not necessary to obtain substantial justice. Our practice with reference to the number of classes is to be commended, but the limits of the several classes are so made as to place too many in a favored position.

As to exemptions, those granted to persons other than direct heirs should be for purely administrative reasons, and therefore very small. Those granted to direct heirs should be large enough to avoid working hardship in any instance. Ten or twelve thousand dollars is not too large. The exemption should apply to the share received by each heir rather than to the estate as a whole, and a deduction should be granted on larger shares, so as to avoid injustice as between heirs.

And, finally, as to the rates which should obtain. For the same reason that the exemption accorded direct heirs should be large, the rate on the smaller taxable shares going to them should be small, say 1 per cent. The ability of other heirs to pay taxes is greatly increased, and (assuming three classes of heirs) the lowest rates might well be as much as 4 per cent for brothers and sisters, uncles and aunts, and their descendants, and 6 per cent for more distant relatives and strangers in blood. The rates should be progressive. Ability increases more rapidly than the amount of the share. Furthermore, heavier taxation of the larger shares encourages a more general distribution of the estate. The progression of rates might cease at 5 per cent, or, if fiscal needs were great, at 10 per cent, in the case of direct heirs; at 12 and 15, or 15 and 20 per

cent in the case of other heirs, according as they belong to the second or the third class. The progression should be sufficiently rapid to bring the maximum rate into use when the share exceeds $500,000. To avoid injustice, it would be well to have the higher rates apply to the fractional parts of the distributive share falling within the limits of the several classes.

The suggested provisions are somewhat less radical than those now obtaining in the British and the French succession taxes. Were they adopted and more attention given to the details relating to tax administration, the revenue produced would be materially increased, and would stand as an important item among the treasury receipts.

TABLE I. — REVENUE DERIVED FROM STATE INHERITANCE TAXES SINCE 1885[1]

(The figures denote thousands of dollars; thus, 31.2 = $31,200.)

Year[2]	Maine	Vermont	Massachusetts[3]	Connecticut	New York	New Jersey	Pennsylvania	Delaware	Maryland	West Virginia	Virginia	North Carolina
1904	—	37.2	—	—	—	—	—	—	—	—	—	—
1903	31.2	29.4	506.1	249.7	4,665.7	138.9	1,300.8	*	67.7	1.4	19.6	*
1902	39.9	55.1	427.7	335.7	3,303.6	149.6	1,231.7	1.0	89.5	6.3	*	4.2
1901	38.9	50.8	506.1	222.3	4,084.6	163.7	1,232.1	1.3	90.7	2.6	28.3	.2
1900	18.0	26.3	398.0	165.9	4,334.8	177.0	1,167.7	2.2	54.5	3.8	21.9	*
1899	36.3	13.7	478.7	115.2	2,194.6	85.5	933.6	1.4	58.5	15.5	67.2	*
1898	23.3	11.5	563.7	133.0	1,997.2	112.9	834.9	.3	134.3	2.5	14.3	1.1
1897	28.7	.5	501.4	77.5	1,829.9	113.8	894.7	*	60.3	1.8	1.7	.1
1896	23.2	—	275.4	135.8	1,796.6	82.2	925.7	.8	76.9	1.4	2.8	
1895	42.3	—	419.4	68.8	2,126.8	121.3	1,092.0	1.6	83.2	1.0		
1894	12.1	—	239.4	74.2	1,689.0	204.7	869.2	*	62.7	6.6		
1893	1.0	—	59.4	143.6	3,071.7	44.2	1,124.5	*	70.7	4.7		
1892	—	—	13.9	177.7	1,786.2	21.0	1,110.6	1.2	114.0	1.0		
1891	—	—	—	74.8	890.3	—	1,230.7	.9	67.7	.3		
1890	—	—	—	14.6	1,117.6	—	670.1	—	83.7	.2		
1889	—	—	—	—	1,075.7	—	1,377.5	—	56.4	.1		
1888	—	—	—	—	736.1	—	713.2	—	57.8			
1887	—	—	—	—	561.7	—	762.7	—	45.6			
1886	—	—	—	—	84.1	—	662.1	—	52.2			
1885	—	—	—	—	—	—	797.0	—	147.0			

Year[2]	Ohio[4]	Illinois	Michigan	Wisconsin	Iowa	Missouri	Nebraska	Tennessee	Montana[6]	Colorado	Utah	Washington	California
1904	—	—	—	—	—	—	—	—	—	—	—	—	286.7
1903	39.3	519.3	164.7	*	234.7[5]	142.6	3.3	*	—	5.0[5]	44.1	35.8[5]	290.4
1902	13.1	1,007.6[5]	211.8	*	—	229.8	.065	74.4	72.7[5]	—	1.6	—	287.0
1901	13.5	—	10.4	32.1	196.5[5]	213.3	—	37.3	—	—	—	3.1	243.6
1900	22.9	958.8[5]	4.6	4.2	—	3.9	—	61.0	13.7[5]	—	—	—	386.9
1899	17.5	—	—	—	52.8[5]	—	—	*	—	—	—	—	157.7
1898	24.2	39.2[5]	—	—	—	—	—	*	7.0	—	—	—	83.6
1897	24.9	—	—	—	—	—	—	*	—	—	—	—	60.7
1896	1.5	.3	—	—	—	—	—	*	—	—	—	—	102.7
1895	—	—	—	—	—	—	—	*	—	—	—	—	32.9
1894	—	—	—	—	—	—	—	*	—	—	—	—	1.4

* Not ascertained. Not reported separately in Tennessee till 1900

[1] North Dakota, Oregon, Wyoming, Arkansas, and Louisiana are not included, the laws going into effect but recently in the first three, and reports being unavailable for the latter two.

[2] Fiscal year ending as indicated, usually June 30 or December 31.

[3] Does not include interest payments.

[4] State revenue only. Counties retain 25 per cent of revenue collected.

[5] Includes yield of tax for preceding year.

[6] State revenue only. Counties retain 40 per cent of the revenue collected.

TABLE II. — REVENUE FROM THE INHERITANCE TAX

(Figures within parentheses indicate the number of years considered.)

State	For Period	Per Capita Revenue	Percentage of Total Revenue
New York	1899–1901 (3)	$0.4873	12.01
Pennsylvania	1902–1903 (2)	.20	5.75
Connecticut	1899–1901 (3)	.1847	5.73
California	1899–1901 (3)	.1766	2.88
Massachusetts	1899–1901 (3)	.1656	4.96
Montana	1900–1902 (2)	.1493[1]	4.68
Vermont	1900–1902 (3)	.1282	—
Illinois	1898–1902 (4)	.102	7.45
Michigan	1902–1903 (2)	.0778	2.42
New Jersey	1899–1901 (3)	.0754	4.0
Missouri	1902–1903 (2)	.0599	3.46
Maryland	1899–1901 (3)	.0572	1.91
Iowa	1900–1903 (4)	.0483	3.82
Maine	1899–1901 (3)	.0447	—
Ohio	1899–1901 (3)	.0433[2]	2.28
Tennessee	1900–1902 (3)	.0285	—
Virginia	1903 (1)	.0106	0.53
West Virginia	1899–1901 (3)	.0076	—

TABLE III. — REVENUE FROM THE INHERITANCE TAX IN FOREIGN COUNTRIES

(Figures within parentheses indicate the number of years considered.)

Country	For Period	Per Capita Revenue	Percentage of Total Revenue
United Kingdom	1900–1903 (3)	$2.06	9.97[3]
France	1900–1901 (2)	1.091	6.03
South Australia	1900–1903 (3)	1.024	3.93
Victoria	1900–1903 (3)	.72	3.6
West Australia	1900–1902 (2)	.223	—
Tasmania	1900–1903 (3)	.216	1.76
British Columbia	1901–1903 (3)	.182	1.79
Ontario	1901–1903 (3)	.151	6.96
Quebec	1901–1903 (3)	.109	3.92
Nova Scotia	1901–1903 (3)	.10	3.92
New Brunswick	1901–1903 (3)	.052	1.95

[1] 60 per cent of the yield, the counties retaining 40 per cent.
[2] 75 per cent of the yield, the counties retaining 25 per cent.
[3] Percentage of total national revenue derived from the various "duties."

CHAPTER XVII

TAXES UPON COMMODITIES

64. Adam Smith's Discussion. — After treating of capitation and income taxes Smith proceeds to consider "Taxes upon Consumable Commodities." He says: [1]

The impossibility of taxing the people, in proportion to their revenue, by any capitation, seems to have given occasion to the invention of taxes upon consumable commodities. The state not knowing how to tax directly and proportionably the revenue of its subjects, endeavors to tax it indirectly by taxing their expense, which, it is supposed, will in most cases be nearly in proportion to their revenue. Their expense is taxed by taxing the consumable commodities upon which it may be laid out.

Consumable commodities are either necessaries or luxuries.

By necessaries I understand, not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. A linen shirt for example is strictly speaking not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably though they had no linen. But in the present times, through the greater part of Europe, a creditable day-laborer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty, which, it is presumed, nobody can well fall into without extreme bad conduct. Custom, in the same manner, has rendered leather shoes a necessary of life in England. The poorest creditable person of either sex would be ashamed to appear in public without them. In Scotland custom has rendered them a necessary of life to the lowest order of men; but not to the same order of

[1] Wealth of Nations, Bk. V, ch. 2.

women, who may, without any discredit, walk about barefooted. In France they are necessaries neither to men nor to women; the lowest rank of both sexes appearing there publicly, without any discredit, sometimes in wooden shoes and sometimes barefooted. Under necessaries therefore, I comprehend, not only those things which nature, but those things which the established rules of decency, have rendered necessary to the lowest rank of people. All other things I call luxuries; without meaning by this appellation to throw the smallest degree of reproach upon the temperate use of them. Beer and ale, for example, in Great Britain, and wine, even in the wine countries, I call luxuries. A man of any rank may, without any reproach, abstain totally from tasting any such liquors. Nature does not render them necessary for the support of life, and custom nowhere renders it indecent for people to live without them.

As the wages of labor are everywhere regulated, partly by the demand for it, and partly by the average price of the necessary articles of subsistence, whatever raises this average price must necessarily raise those wages, so that the laborer may still be able to purchase that quantity of those necessary articles which the state of the demand for labor, whether increasing, stationary, or declining, requires that he should have. A tax upon those articles necessarily raises their price somewhat higher than the amount of the tax, because the dealer, who advances the tax, must generally get it back with a profit. Such a tax must therefore occasion a rise in the wages of labor proportionable to this rise of price.

It is thus that a tax upon the necessaries of life operates exactly in the same manner as a direct tax upon the wages of labor. The laborer, though he may pay it out of his hand, cannot, for any considerable time at least, be properly said even to advance it. It must always in the long run be advanced to him by his immediate employer in the advanced rate of wages. His employer, if he is a manufacturer, will charge upon the price of his goods this rise of wages, together with a profit; so that the final payment of the tax, together with this overcharge, will fall upon the consumer. If his employer is a farmer, the final payment, together with a like overcharge, will fall upon the rent of the landlord.

It is otherwise with taxes upon what I call luxuries; even upon those of the poor. The rise in the price of the taxed commodities will not necessarily occasion any rise in the wages of labor. A tax upon tobacco, for example, though a luxury of the poor as well as of the rich, will not raise wages. Though it is taxed in England at three times, and in France at fifteen times, its original price, those high duties seem to have no effect upon the wages of labor. The same thing may be said of the taxes upon tea and sugar, which in England and Holland have become luxuries of the lowest ranks of people; and of those upon chocolate, which in Spain is said to have become so. The different taxes which in Great Britain have, in the course of the present century, been imposed upon spirituous liquors, are not supposed to have had any effect upon the wages of labor. The rise in the price of porter, occasioned by an additional tax of 3*s.* upon the barrel of strong beer, has not raised the wages of common labor in London. These were about 18*d.* and 20*d.* a day before a tax, and they are not more now.

The high price of such commodities does not necessarily diminish the ability of the inferior ranks of people to bring up families. Upon the sober and industrious poor, taxes upon such commodities act as sumptuary laws, and dispose them either to moderate or to refrain altogether from the use of superfluities which they can no longer easily afford. Their ability to bring up families, in consequence of this forced frugality, instead of being diminished, is frequently perhaps increased by tax. It is the sober and industrious poor who generally bring up the most numerous families, and who principally supply the demand for useful labor.

* * * * * * *

In Great Britain the principal taxes upon the necessaries of life are those upon the four commodities just now mentioned, — salt, leather, soap, and candles.

Salt is a very ancient and a very universal subject of taxation. It was taxed among the Romans, and it is so at present in, I believe, every part of Europe. The quantity annually consumed by any individual is so small, and may be purchased so gradually, that nobody, it seems to have been thought, could feel very sensibly even a pretty heavy tax upon it. It is in England taxed

at 3*s.* 4*d.* a bushel; about three times the original price of the commodity. In some other countries the tax is still higher. Leather is a real necessary of life. The use of linen renders soap such. In countries where the winter nights are long, candles are a necessary instrument of trade. Leather and soap are in Great Britain taxed at 3 halfpence a pound; candles at a penny; taxes which, upon the original price of leather, may amount to about 8 or 10 per cent; upon that of soap to about 20 or 25 per cent; and upon that of candles to about 14 or 15 per cent; taxes, which though lighter than that upon salt, are still very heavy. As all those four commodities are real necessaries of life, such heavy taxes upon them must increase somewhat the expense of the sober and industrious poor, and must consequently raise more or less the wages of their labor.

In a country where the winters are so cold as in Great Britain, fuel is, during that season, in the strictest sense of the word, a necessary of life, not only for the purpose of dressing victuals, but for the comfortable subsistence of many different sorts of workmen who work within doors; and coals are the cheapest of all fuel. The price of fuel has so important an influence upon that of labor, that all over Great Britain manufactures have confined themselves principally to the coal countries; other parts of the country, on account of the high price of this necessary article, not being able to work so cheap. In some manufactures, besides, coal is a necessary instrument of trade; as in those of glass, iron, and all other metals. If a bounty could in any case be reasonable, it might perhaps be so upon the transportation of coals from those parts of the country in which they abound, to those in which they are wanted. But the legislature, instead of a bounty, has imposed a tax of 3*s.* 3*d.* a ton upon coal carried coastways; which upon most sorts of coal is more than 60 per cent of the original price at the coal pit. Coals carried either by land or by inland navigation pay no duty. Where they are naturally cheap, they are consumed duty free; where they are naturally dear, they are loaded with a heavy duty.

Such taxes, though they raise the price of subsistence, and consequently the wages of labor, yet they afford a considerable revenue to government, which it might not be easy to find in any other way. There may, therefore, be a good reason for

continuing them. The bounty upon the exportation of corn, so far as it tends in the actual state of tillage to raise the price of that necessary article, produces all the like bad effects; and instead of affording any revenue, frequently occasions a very great expense to government. The high duties upon the importation of foreign corn, which in years of moderate plenty amount to a prohibition; and the absolute prohibition of the importation either of live cattle or of salt provisions, which takes place in the ordinary state of the law, and which, on account of the scarcity, is at present suspended for a limited time with regard to Ireland and the British plantations, have all the bad effects of taxes upon the necessaries of life, and produce no revenue to government. Nothing seems necessary for the repeal of such regulations, but to convince the public of the futility of that system in consequence of which they have been established.

Taxes upon the necessaries of life are much higher in many other countries than in Great Britain. Duties upon flour and meal when ground at the mill, and upon bread when baked at the oven, take place in many countries. In Holland the money price of the bread consumed in towns is supposed to be doubled by means of such taxes. In lieu of a part of them, the people who live in the country pay every year so much a head, according to the sort of bread they are supposed to consume. Those who consume wheaten bread, pay 3 guilders 15 stivers; about 6*s.* $9\frac{1}{2}$*d.* These, and some other taxes of the same kind, by raising the price of labor, are said to have ruined the greater part of the manufactures of Holland. Similar taxes, though not quite so heavy, take place in the Milanese, in the states of Genoa, in the duchy of Modena, in the duchies of Parma, Placentia, and Guastalla, and in the ecclesiastical state. A French author (La Réformateur) of some note has proposed to reform the finances of his country by substituting in the room of the greater part of other taxes, this most ruinous of all taxes. "There is nothing so absurd," says Cicero, "which has not sometimes been asserted by some philosophers."

Taxes upon butcher's meat are still more common than those upon bread. It may indeed be doubted whether butcher's meat is anywhere a necessary of life. Grain and other vegetables, with the help of milk, cheese, and butter, or oil where butter is

not to be had, it is known from experience, can, without any butcher's meat, afford the most plentiful, the most wholesome, the most nourishing, and the most invigorating diet. Decency nowhere requires that any man should eat butcher's meat, as it in most places requires that he should wear a linen shirt or a pair of leather shoes.

Consumable commodities, whether necessaries or luxuries, may be taxed in two different ways. The consumer may either pay an annual sum on account of his using or consuming goods of a certain kind; or the goods may be taxed while they remain in the hands of the dealer, and before they are delivered to the consumer. The consumable goods which last a considerable time before they are consumed altogether, are most properly taxed in the one way. Those of which the consumption is either immediate or more speedy, in the other. The coach tax and the plate tax are examples of the former method of imposing; the greater part of the other duties of excise and customs, of the latter.

* * * * * * *

The duties of excise are imposed chiefly upon goods of home produce, destined for home consumption. They are imposed only upon a few sorts of goods of the most general use. There can never be any doubt either concerning the goods which are subject to those duties, or the particular duty which each species of goods is subject to. They fall, almost altogether, upon what I call luxuries, excepting always the four duties mentioned, upon salt, soap, leather, candles, and, perhaps, that upon green glass.

The duties of customs are much more ancient than those of excise. They seem to have been called customs, as denoting customary payments which had been in use from time immemorial. They appear to have been originally considered as taxes upon the profits of merchants. During the barbarous times of feudal anarchy, merchants, like all the other inhabitants of burghs, were considered as little better than emancipated bondmen, whose persons were despised, and whose gains were envied. The great nobility, who had consented that the king should tallage the profits of their own tenants, were not unwilling that he should tallage likewise those of an order of men whom it was much less their interest to protect. In those igno-

rant times, it was not understood that the profits of merchants are a subject not taxable directly; or that the final payment of all such taxes must fall, with a considerable overcharge, upon the consumers.

The gains of alien merchants were looked upon more unfavorably than those of English merchants. It was natural that those of the former should be taxed more heavily than those of the latter. This distinction between the duties upon aliens and those upon English merchants, which was begun from ignorance, has been continued from the spirit of monopoly, or in order to give our own merchants an advantage both in the home and in the foreign market.

With this distinction, the ancient duties of customs were imposed equally upon all sorts of goods, necessaries as well as luxuries, goods exported as well as imported. Why should the dealers in one sort of goods, it seems to have been thought, be more favored than those in another? or why should the merchant exporter be more favored than the merchant importer?

The ancient customs were divided into three branches. The first, and, perhaps, the most ancient of all those duties, was that upon wool and leather. It seems to have been chiefly or altogether an exportation duty. When the woolen manufacture came to be established in England, lest the king should lose any part of his customs upon wool, by the exportation of woolen cloths, a like duty was imposed upon them. The other two branches were — I. A duty upon wine, which, being imposed at so much a ton, was called a tonnage; and, II, a duty upon all other goods, which, being imposed at so much a pound of their supposed value, was called a poundage. In the forty-seventh year of Edward III, a duty of sixpence in the pound was imposed upon all goods, exported and imported, except wools, woolfells, leather, and wines, which were subject to particular duties. In the fourteenth of Richard II, this duty was raised to one shilling in the pound; but, three years afterward, it was again reduced to sixpence. It was raised to eightpence in the second year of Henry IV; and in the fourth year of the same prince, to one shilling. From this time, to the ninth year of William III, this duty continued at one shilling in the pound. The duties of tonnage and poundage were generally granted to

the king by one and the same act of parliament, and were called the subsidy of tonnage and poundage. The subsidy of poundage having continued for so long a time at one shilling in the pound, or at 5 per cent, a subsidy came, in the language of the customs, to denote a general duty of this kind of 5 per cent. This subsidy, which is now called the old subsidy, still continues to be levied according to the book of rates established in the twelfth of Charles II. The method of ascertaining, by a book of rates, the value of goods subject to this duty, is said to be older than the time of James I. The new subsidy imposed by the ninth and tenth of William III, was an additional 5 per cent upon the greater part of the goods. The one-third and the two-third subsidy made up between them another 5 per cent, of which they were proportionable parts. The subsidy of 1747 made a fourth 5 per cent upon the greater part of goods; and that of 1759, a fifth upon some particular sorts of goods. Besides those five subsidies, a great variety of other duties have occasionally been imposed upon particular sorts of goods, in order sometimes to relieve the exigencies of the state, and sometimes to regulate the trade of the country, according to the principles of the mercantile system.

That system has come gradually more and more into fashion. The old subsidy was imposed indifferently upon exportation as well as importation. The four subsequent subsidies, as well as the other duties which have since been occasionally imposed upon particular sorts of goods, have, with a few exceptions, been laid altogether upon importation. The greater part of the ancient duties which had been imposed upon the exportation of goods of home produce and manufacture, have either been lightened or taken away altogether. In most cases they have been taken away. Bounties have even been given upon the exportation of some of them. Drawbacks, too, sometimes of the whole, and, in most cases, of a part of the duties which are paid upon the importation of foreign goods, have been granted upon their exportation. Only half the duties imposed by the old subsidy upon importation are drawn back upon exportation; but the whole of those imposed by the latter subsidies and other imposts are, upon the greater part of goods, drawn back in the same manner. This growing favor of exportation, and dis-

couragement of importation, have suffered only a few exceptions, which chiefly concern the materials of some manufactures. These, our merchants and manufacturers are willing should come as cheap as possible to themselves, and as dear as possible to their rivals and competitors in other countries. Foreign materials are, upon this account, sometimes allowed to be imported duty free; Spanish wool, for example, flax, and raw linen yarn. The exportation of the materials of home produce, and of those which are the particular produce of our colonies, has sometimes been prohibited, and sometimes subjected to higher duties. The exportation of English wool has been prohibited. That of beaver skins, of beaver wool, and of gum senega, has been subjected to higher duties; Great Britain, by the conquest of Canada and Senegal, having got almost the monopoly of those commodities.

That the mercantile system has not been very favorable to the revenue of the great body of the people, to the annual produce of the land and labor of the country, I have endeavored to show in the fourth book of this inquiry. It seems not to have been more favorable to the revenue of the sovereign; so far, at least, as that revenue depends upon the duties of customs.

In consequence of that system, the importation of several sorts of goods has been prohibited altogether. This prohibition has in some cases entirely prevented, and in others has very much diminished, the importation of those commodities, by reducing the importers to the necessity of smuggling. It has entirely prevented the importation of foreign woolens, and it has very much diminished that of foreign silks and velvets. In both cases, it has entirely annihilated the revenue of customs which might have been levied upon such importation.

The high duties which have been imposed upon the importation of many different sorts of foreign goods, in order to discourage their consumption in Great Britain, have in many cases served only to encourage smuggling; and in all cases have reduced the revenue of the customs below what more moderate duties would have afforded. The saying of Dr. Swift, that, in the arithmetic of the customs, two and two, instead of making four, make sometimes only one, holds perfectly true with regard to such heavy duties, which never could have been imposed,

had not the mercantile system taught us, in many cases, to employ taxation as an instrument, not of revenue, but of monopoly.

The bounties which are sometimes given upon the exportation of home produce and manufactures, and the drawbacks which are paid upon the reëxportation of the greater part of foreign goods, have given occasion to many frauds, and to a species of smuggling more destructive of the public revenue than any other. In order to obtain the bounty or drawback, the goods, it is well known, are sometimes shipped and sent to sea, but soon afterward clandestinely relanded in some other part of the country. The defalcation of the revenue of customs occasioned by bounties and drawbacks, of which a great part are obtained fraudulently, is very great. The gross produce of the customs in the year which ended on the 5th of January, 1755, amounted to £5,068,000. The bounties which were paid out of this revenue, though in that year there was no bounty upon corn, amounted to £167,800. The drawbacks which were paid upon debentures and certificates to £2,156,800. Bounties and drawbacks together amounted to £2,324,600. In consequence of these deductions, the revenue of the customs amounted only to £2,743,400; from which deducting £287,900 for the expense of management in salaries and other incidents, the net revenue of the customs for that year comes out to be £2,455,500. The expense of management amounts in this manner to between 5 and 6 per cent upon the gross revenue of the customs, and to something more than 10 per cent upon what remains of that revenue, after deducting what is paid away in bounties and drawbacks.

Heavy duties being imposed upon almost all goods imported, our merchant importers smuggle as much and make entry of as little as they can. Our merchant exporters, on the contrary, make entry of more than they export; sometimes out of vanity, and to pass for great dealers in goods which pay no duty, and sometimes to gain a bounty or a drawback. Our exports, in consequence of these different frauds, appear upon the customhouse books greatly to overbalance our imports, to the unspeakable comfort of those politicians who measure the national prosperity by what they call the balance of trade.

All goods imported, unless particularly exempted, and such

exemptions are not very numerous, are liable to some duties of customs. If any goods are imported not mentioned in the book of rates, they are taxed at $4s.\ 9\frac{9}{20}d.$ for every $20s.$ value, according to the oath of the importer, that is, nearly at five subsidies, or five poundage duties. The book of rates is extremely comprehensive, and enumerates a great variety of articles, many of them little used, and, therefore, not well known. It is upon this account frequently uncertain under what article a particular sort of goods ought to be classed, and, consequently, what duty they ought to pay. Mistakes with regard to this sometimes ruin the customhouse officer, and frequently occasion much trouble, expense, and vexation to the importer. In point of perspicuity, precision, and distinctness, therefore, the duties of customs are much inferior to those of excise.

In order that the greater part of the members of any society should contribute to the public revenue in proportion to their respective expense, it does not seem necessary that every single article of that expense should be taxed. The revenue, which is levied by the duties of excise, is supposed to fall as equally upon the contributors as that which is levied by the duties of customs; and the duties of excise are imposed upon a few articles only of the most general use and consumption. It has been the opinion of many people that, by proper management, the duties of customs might likewise, without any loss to the public revenue, and with great advantage to the foreign trade, be confined to a few articles only.

The foreign articles, of the most general use and consumption in Great Britain, seem at present to consist chiefly in foreign wines and brandies; in some of the productions of America and the West Indies, sugar, rum, tobacco, cocoanuts, etc., and in some of those of the East Indies, tea, coffee, chinaware, spiceries of all kinds, several sorts of piece-goods, etc. These different articles afford, perhaps, at present, the greater part of the revenue which is drawn from the duties of customs. The taxes which at present subsist upon foreign manufactures, if you except those upon the few contained in the foregoing enumeration, have the greater part of them been imposed for the purpose, not of revenue, but of monopoly, or to give our own merchants an advantage in the home market. By remov-

ing all prohibitions, and by subjecting all foreign manufactures to such moderate taxes, as it was found from experience, afforded upon each article the greatest revenue to the public, our own workmen might still have a considerable advantage in the home market, and many articles, some of which at present afford no revenue to government, and others a very inconsiderable one, might afford a very great one.

High taxes, sometimes by diminishing the consumption of the taxed commodities, and sometimes by encouraging smuggling, frequently afford a smaller revenue to government than what might be drawn from more moderate taxes.

When the diminution of revenue is the effect of the diminution of consumption, there can be but one remedy, and that is, the lowering of the tax imposed.

When the diminution of the revenue is the effect of the encouragement given to smuggling, it may, perhaps, be remedied in two ways: either by diminishing the temptation to smuggle, or by increasing the difficulty of smuggling. The temptation to smuggle can be diminished only by the lowering of the tax; and the difficulty of smuggling can be increased only by establishing that system of administration which is most proper for preventing it.

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If by such a system of administration smuggling, to any considerable extent, could be prevented, even under pretty high duties; and if every duty was occasionally either heightened or lowered according as it was most likely, either the one way or the other, to afford the greatest revenue to the state (taxation being always employed as an instrument of revenue and never of monopoly); it seems not improbable that a revenue, at least equal to the present net revenue of the customs, might be drawn from duties upon the importation of only a few sorts of goods of the most general use and consumption; and that the duties of customs might thus be brought to the same degree of simplicity, certainty, and precision, as those of excise. What the revenue at present loses, by drawbacks upon the reëxportation of foreign goods which are afterward re-landed and consumed at home, would, under this system, be saved altogether. If to this saving, which would alone be very considerable, were added the aboli-

tion of all bounties upon the exportation of home produce, in all cases in which those bounties were not in reality drawbacks of some duties of excise which had before been advanced; it cannot well be doubted but that the net revenue of customs might, after an alteration of this kind, be fully equal to what it had ever been before.[1]

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The duties upon foreign luxuries imported for home consumption, though they sometimes fall upon the poor, fall principally upon the people of middling or more than middling fortune. Such are the duties upon foreign wines, coffee, chocolate, tea, sugar, etc.

The duties upon the cheaper luxuries of home produce destined for home consumption, fall pretty equally upon people of all ranks in proportion to their respective expense. The poor pay the duties upon malt, hops, beer, and ale, upon their own consumption; the rich, upon their own consumption and that of their servants.

The whole consumption of the inferior ranks of people, or of those below the middling rank, it must be observed, is in every country much greater, not only in quantity, but in value, than that of the middling, and of those above the middling rank. The whole expense of the inferior is much greater than that of the superior ranks. I. Almost the whole capital of every country is annually distributed among the inferior ranks of people, as wages of productive labor. II. A great part of the revenue arising from both the rent of land and the profits of stock, is annually distributed among the same rank, in the wages and maintenance of menial servants, and other unproductive laborers. III. Some part of the profits of stock belongs to the same rank as a revenue arising from the employment of their small capitals. The amount of the profits annually made by small shopkeepers, tradesmen, and retailers of all kinds, is everywhere very considerable, and makes a very considerable portion of the annual produce. IV. Some part even of the rent of land belongs to the same rank; a considerable part to those who are somewhat below the middling rank, and a small part even to the lowest rank;

[1] This general plan of reforming the customs marked out the precise directions which British fiscal legislation took in the nineteenth century. — ED.

common laborers sometimes possessing in property an acre or two of land. Though the expense of those inferior ranks of people, taking them individually, is very small, yet the whole mass of it, taking them collectively, amounts always to by much the largest portion of the whole expense of the society; what remains, of the annual produce of the land and labor of the country for the consumption of the superior ranks, being always much less, not only in quantity, but in value. The taxes upon expense, which fall chiefly upon that of the superior ranks of people, upon the smaller portion of the annual produce, are likely to be much less productive than either those which fall indifferently upon the expense of all ranks, or even those which fall chiefly upon that of the inferior ranks, than either those which fall indifferently upon the whole annual produce, or those which fall chiefly upon the larger portion of it. The excise upon the materials and manufacture of home-made fermented and spirituous liquors is accordingly, of all the different taxes upon expense, by far the most productive; and this branch of the excise falls very much, perhaps principally, upon the expense of the common people. In the year which ended on the 5th of July, 1775, the gross produce of this branch of the excise amounted to £3,341,837, 9*s*. 9*d*.

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Such taxes upon luxuries as the greater part of the duties of customs and excise, though they all fall indifferently upon every different species of revenue, and are paid finally, or without any retribution, by whoever consumes the commodities upon which they are imposed, yet they do not always fall equally or proportionately upon the revenue of every individual. As every man's humor regulates the degree of his consumption, every man contributes rather according to his humor than in proportion to his revenue; the profuse contribute more, the parsimonious less, than their proper proportion. During the minority of a man of great fortune, he contributes commonly very little, by his consumption, toward the support of that state from whose protection he derives a great revenue. Those who live in another country contribute nothing by their consumption, toward the support of the government of that country in which is situated the source of their revenue. If in this latter country there

should be no land tax, nor any considerable duty upon the transference either of movable or immovable property, as is the case of Ireland, such absentees may derive a great revenue from the protection of a government to the support of which they do not contribute a single shilling. This inequality is likely to be greatest in a country of which the government is in some respects subordinate and dependent upon that of some other. The people who possess the most extensive property in the dependent, will in this case generally choose to live in the governing country. Ireland is precisely in this situation, and we cannot therefore wonder that the proposal of a tax upon absentees should be so very popular in that country. It might, perhaps, be a little difficult to ascertain either what sort, or what degree of absence would subject a man to be taxed as an absentee, or at what precise time the tax should either begin or end. If you except, however, this very peculiar situation, any inequality in the contribution of individuals, which can arise from such taxes, is much more than compensated by the very circumstance which occasions that inequality; the circumstance that every man's contribution is altogether voluntary; it being altogether in his power either to consume or not to consume the commodity taxed. Where such taxes, therefore, are properly assessed, and upon proper commodities, they are paid with less grumbling than any other. When they are advanced by the merchant or manufacturer, the consumer, who finally pays them, soon comes to confound them with the price of the commodities, and almost forgets that he pays any tax.[1]

Such taxes are or may be perfectly certain, or may be assessed so as to leave no doubt concerning either what ought to be paid or when it ought to be paid, concerning either the quantity or the time of payment. Whatever uncertainty there may some-

[1] With this it is interesting to compare the following passage from Hume's Essay on Taxes (1752):

"The best taxes are such as are levied upon consumptions, especially those of luxury; because such taxes are least felt by the people. They seem, in some measure, voluntary; since a man may chuse how far he will use the commodity which is taxed: They are paid gradually and insensibly: They naturally produce sobriety and frugality, if judiciously imposed: And being confounded with the natural price of the commodity, they are scarcely perceived by the consumers. Their only disadvantage is, that they are expensive in the levying."

times be, either in the duties of customs in Great Britain, or in other duties of the same kind in other countries, it cannot arise from the nature of those duties, but from the inaccurate or unskillful manner in which the law that imposes them is expressed.

Taxes upon luxuries generally are, and always may be paid piecemeal, or in proportion as the contributors have occasion to purchase the goods upon which they are imposed. In the time and mode of payment they are, or may be, of all taxes the most convenient. Upon the whole, such taxes are perhaps as agreeable to the three first of the four general maxims concerning taxation, as any other. They offend in every respect against the fourth.

Such taxes, in proportion to what they bring into the public treasury of the state, always take out or keep out of the pockets of the people more than almost any other taxes. They seem to do this in all the four different ways in which it is possible to do it.

I. The levying of such taxes, even when imposed in the most judicious manner, requires a great number of customhouse and excise officers, whose salaries and perquisites are a real tax upon the people, which brings nothing into the treasury of the state. This expense, however, it must be acknowledged, is more moderate in Great Britain than in most other countries. In the year which ended on the 5th of July, 1775, the gross produce of the different duties, under the management of the commissioners of excise in England, amounted to £5,507,308, 18*s*. 8¼*d*., which was levied at an expense of little more than 5½ per cent. From this gross produce there must be deducted what was paid away in bounties and drawbacks upon the exportation of excisable goods, which will reduce the net produce below $5,000,000.[1] The levying of the salt duty, an excise duty, but under a different management, is much more expensive. The net revenue of the customs does not amount to £2,500,000, which is levied at an expense of more than 10 per cent in the salaries of officers, and other incidents. But the perquisites of customhouse officers are everywhere much greater than their salaries, at some ports more than double or triple those salaries. If the salaries

[1] The net produce, deducting expenses and allowances, amounted to £4,976,652, 19*s*. 6*d*.

of officers, and other incidents, therefore, amount to more than 10 per cent upon the net revenue of the customs, the whole expense of levying that revenue may amount, in salaries and perquisites together, to more than 20 or 30 per cent. The officers of excise receive few or no perquisites; and the administration of that branch of the revenue being of more recent establishment, is in general less corrupted than that of the customs, into which length of time has introduced and authorized many abuses. By charging upon malt the whole revenue which is at present levied by the different duties upon malt and liquors, a saving, it is supposed, of more than £50,000 might be made in the annual expense of the excise. By confining the duties of customs to a few sorts of goods, and by levying those duties according to the excise laws, a much greater saving might probably be made in the annual expense of the customs.

II. Such taxes necessarily occasion some obstruction or discouragement to certain branches of industry. As they always raise the price of the commodity taxed, they so far discourage its consumption, and consequently its production. If it is a commodity of home growth or manufacture, less labor comes to be employed in raising and producing it. If it is a foreign commodity, of which the tax increases in this manner the price, the commodities of the same kind which are made at home may thereby, indeed, gain some advantage in the home market, and a greater quantity of domestic industry may thereby be turned toward preparing them. But though this rise of price in a foreign commodity may encourage domestic industry in one particular branch, it necessarily discourages that industry in almost every other. The dearer the Birmingham manufacturer buys his foreign wine, the cheaper he necessarily sells that part of his hardware with which, or, what comes to the same thing, with the price of which he buys it. That part of his hardware becomes of less value to him, and he has less encouragement to work at it. The dearer the consumers in one country pay for the surplus produce of another, the cheaper they necessarily sell that part of their own surplus produce with which, or, what comes to the same thing, with the price of which they buy it. That part of their own surplus produce becomes of less value to them, and they have less encouragement to increase its quantity. All taxes

upon consumable commodities tend to reduce the quantity of productive labor below what it otherwise would be, either in preparing the commodities taxed, if they are home commodities, or in preparing those with which they are purchased, if they are foreign commodities. Such taxes, too, always alter, more or less, the natural direction of national industry, and turn it into a channel always different from, and generally less advantageous than, that in which it would have run of its own accord.

III. The hope of evading such taxes by smuggling gives frequent occasion to forfeitures and other penalties, which entirely ruin the smuggler; a person who, though no doubt highly blamable for violating the laws of his country, is frequently incapable of violating those of natural justice, and would have been, in every respect, an excellent citizen, had not the laws of his country made that a crime which nature never meant to be so. In those corrupted governments where there is at least a general suspicion of much unnecessary expense, and great misapplication of the public revenue, the laws which regard it are little respected. Not many people are scrupulous about smuggling, when, without perjury, they can find an easy and safe opportunity of doing so. To pretend to have any scruple about buying smuggled goods, though a manifest encouragement to the violation of the revenue laws, and to the perjury which almost always attends it, would in most countries be regarded as one of those pedantic pieces of hypocrisy which, instead of gaining credit with anybody, serve only to expose the person who affects to practice them, to the suspicion of being a greater knave than most of his neighbors. By this indulgence of the public, the smuggler is often encouraged to continue a trade which he is thus taught to consider as in some measure innocent; and when the severity of the revenue laws is ready to fall upon him, he is frequently disposed to defend with violence what he has been accustomed to regard as his just property. From being at first, perhaps, rather imprudent than criminal, he at last too often becomes one of the hardiest and most determined violators of the laws of society. By the ruin of the smuggler, his capital, which had before been employed in maintaining productive labor, is absorbed either in the revenue of the state or of the revenue officer, and is employed in maintaining unproductive labor, to the diminution of

the general capital of the society, and of the useful industry which it might otherwise have maintained.

IV. Such taxes, by subjecting at least the dealers in the taxed commodities to the frequent visits and odious examination of the taxgatherers, expose them sometimes, no doubt, to some degree of oppression, and always to some trouble and vexation; and though vexation, as has always been said, is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it. The laws of excise, though more effectual for the purpose for which they were instituted, are, in this respect, more vexatious than those of the customs. When a merchant has imported goods subject to certain duties of customs, when he has paid those duties, and lodged the goods in his warehouse, he is not in most cases liable to any further trouble or vexation from the customhouse officer. It is otherwise with goods subject to duties of excise. The dealers have no respite from the continual visits and examination of the excise officers. The duties of excise are, upon this account, more unpopular than those of the customs; and so are the officers who levy them. Those officers, it is pretended, though in general, perhaps, they do their duty fully as well as those of the customs, yet, as that duty obliges them to be frequently very troublesome to some of their neighbors, commonly contract a certain hardness of character which the others frequently have not. This observation, however, may very probably be the mere suggestion of fraudulent dealers, whose smuggling is either prevented or detected by their diligence.

The inconveniences, however, which are, perhaps, in some degree inseparable from taxes upon consumable commodities, fall as light upon the people of Great Britain as upon those of any other country of which the government is nearly as expensive. Our state is not perfect, and might be mended; but it is as good or better than that of most of our neighbors.

In consequence of the notion that duties upon consumable goods were taxes upon the profits of merchants, those duties have, in some countries, been repeated upon every successive sale of the goods. If the profits of the merchant importer or merchant manufacturer were taxed, equality seemed to require that those of all the middle buyers, who intervened between

either of them and the consumer, should likewise be taxed. The famous Alcavala of Spain seems to have been established upon this principle. It was at first a tax of 10 per cent, afterward of 14 per cent, and is at present of only 6 per cent upon the sale of every sort of property, whether moveable or immovable; and it is repeated every time the property is sold. The levying of this tax requires a great multitude of revenue officers, sufficient to guard the transportation of goods, not only from one province to another, but from one shop to another. It subjects not only the dealers in some sorts of goods, but those in all sorts, every farmer, every manufacturer, every merchant and shopkeeper, to the continual visits and examination of the taxgatherers. Through the greater part of a country in which a tax of this kind is established, nothing can be produced for distant sale. The produce of every part of the country must be proportioned to the consumption of the neighborhood. It is to the Alcavala that Ustaritz imputes the ruin of the manufactures of Spain. He might have imputed to it, likewise, the declension of agriculture, it being imposed not only upon manufactures, but upon the rude produce of the land.

In the kingdom of Naples there is a similar tax of 3 per cent upon the value of all contracts, and consequently upon that of all contracts of sale. It is both lighter than the Spanish tax, and the greater part of towns and parishes are allowed to pay a composition in lieu of it. They levy this composition in what manner they please, generally in a way that gives no interruption to the interior commerce of the place. The Neapolitan tax, therefore, is not near so ruinous as the Spanish one.

The uniform system of taxation, which, with a few exceptions of no great consequence, takes place in all the different parts of the United Kingdom of Great Britain, leaves the interior commerce of the country, the inland and coasting trade, almost entirely free. The inland trade is almost perfectly free, and the greater part of goods may be carried from one end of the kingdom to the other, without requiring any permit or let-pass, without being subject to question, visit, or examination from the revenue officers. There are a few exceptions, but they are such as can give no interruption to any important branch of the inland commerce of the country. Goods carried coastwise, indeed,

require certificates or coast cockets. If you except coals, however, the rest are almost all duty free. This freedom of interior commerce, the effect of the uniformity of the system of taxation, is perhaps one of the principal causes of the prosperity of Great Britain; every great country being necessarily the best and most extensive market for the greater part of the productions of its own industry. If the same freedom, in consequence of the same uniformity, could be extended to Ireland and the colonies, the grandeur of the state and the prosperity of every part of the empire, would probably be much greater than at present.

65. Mill's Comparison of Direct and Indirect Taxes.—Mr. Mill's discussion of the comparative merits of so-called direct and indirect taxation is as follows: [1]

Are direct or indirect taxes the most eligible? This question, at all times interesting, has of late excited a considerable amount of discussion. In England there is a popular feeling, of old standing, in favor of indirect, or it should rather be said in opposition to direct, taxation. The feeling is not grounded on the merits of the case, and is of a puerile kind. An Englishman dislikes, not so much the payment as the act of paying. He dislikes seeing the face of the tax collector, and being subjected to his peremptory demand. Perhaps, too, the money which he is required to pay directly out of his pocket is the only taxation which he is quite sure that he pays at all. That a tax of one shilling per pound on tea, or of two shillings per bottle on wine, raises the price of each pound of tea and bottle of wine which he consumes, by that and more than that amount, cannot indeed be denied; it is the fact, and is intended to be so, and he himself, at times, is perfectly aware of it; but it makes hardly any impression on his practical feelings and associations, serving to illustrate the distinction between what is merely known to be true and what is felt to be so. The unpopularity of direct taxation, contrasted with the easy manner in which the public consent to let themselves be fleeced in the prices of commodities, has generated in many friends of improvement a directly opposite

[1] Principles, Bk. V, ch. 6. For a somewhat more favorable view of indirect taxes, see McCulloch, Treatise on Taxation, 147–162 (second edition).

mode of thinking to the foregoing. They contend that the very reason which makes direct taxation disagreeable, makes it preferable. Under it, every one knows how much he really pays; and if he votes for a war, or any other expensive national luxury, he does so with his eyes open to what it costs him. If all taxes were direct, taxation would be much more perceived than at present; and there would be a security which now there is not, for economy in the public expenditure.

Although this argument is not without force, its weight is likely to be constantly diminishing. The real incidence of indirect taxation is every day more generally understood and more familiarly recognized: and whatever else may be said of the changes which are taking place in the tendencies of the human mind, it can scarcely, I think, be denied, that things are more and more estimated according to their calculated value, and less according to their non-essential accompaniments. The mere distinction between paying money directly to the tax collector, and contributing the same sum through the intervention of the tea dealer or the wine merchant, no longer makes the whole difference between dislike or opposition, and passive acquiescence. But further, while any such infirmity of the popular mind subsists, the argument grounded on it tells partly on the other side of the question. If our present revenue of about seventy millions were all raised by direct taxes, an extreme dissatisfaction would certainly arise at having to pay so much; but while men's minds are so little guided by reason, as such a change of feeling from so irrelevant a cause would imply, so great an aversion to taxation might not be an unqualified good. Of the seventy millions in question, nearly thirty are pledged, under the most binding obligations, to those whose property has been borrowed and spent by the state: and while this debt remains unredeemed, a greatly increased impatience of taxation would involve no little danger of a breach of faith, similar to that which, in the defaulting states of America, has been produced, and in some of them still continues, from the same cause. That part, indeed, of the public expenditure, which is devoted to the maintenance of civil and military establishments, (that is, all except the interest of the national debt), affords, in many of its details, ample scope for retrenchment. But while

much of the revenue is wasted under the mere pretense of public service, so much of the most important business of government is left undone, that whatever can be rescued from useless expenditure is urgently required for useful. Whether the object be education; a more efficient and accessible administration of justice; reforms of any kind which, like the Slave Emancipation, require compensation to individual interests; or what is as important as any of these, the entertainment of a sufficient staff of able and educated public servants, to conduct in a better than the present awkward manner the business of legislation and administration; every one of these things implies considerable expense, and many of them have again and again been prevented by the reluctance which existed to apply to Parliament for an increased grant of public money, though (besides that the existing means would be more than sufficient if applied to the proper purposes) the cost would be repaid, often a hundredfold, in mere pecuniary advantage to the community generally. If so great an addition were made to the public dislike of taxation as might be the consequence of confining it to the direct form, the classes who profit by the misapplication of public money might probably succeed in saving that by which they profit, at the expense of that which would only be useful to the public.

There is, however, a frequent plea in support of indirect taxation, which must be altogether rejected, as grounded on a fallacy. We are often told that taxes on commodities are less burdensome than other taxes, because the contributor can escape from them by ceasing to use the taxed commodity. He certainly can, if that be his object, deprive the government of the money; but he does so by a sacrifice of his own indulgences, which (if he chose to undergo it) would equally make up to him for the same amount taken from him by direct taxation. Suppose a tax laid on wine, sufficient to add £5 to the price of the quantity of wine which he consumes in a year. He has only (we are told) to diminish his consumption of wine by £5, and he escapes the burthen. True: but if the £5, instead of being laid on wine, had been taken from him by an income tax, he could, by expending £5 less in wine, equally save the amount of the tax, so that the difference between the two cases is really illusory. If the government takes from the contributor £5 a year, whether in

one way or another, exactly that amount must be retrenched from his consumption to leave him as well off as before; and in either way the same amount of sacrifice, neither more nor less, is imposed on him.

On the other hand, it is some advantage on the side of indirect taxes, that what they exact from the contributor is taken at a time and in a manner likely to be convenient to him. It is paid at a time when he has at any rate a payment to make; it causes, therefore, no additional trouble, nor (unless the tax be on necessaries) any inconvenience but what is inseparable from the payment of the amount. He can also, except in the case of very perishable articles, select his own time for laying in a stock of the commodity, and consequently for payment of the tax. The producer or dealer who advances these taxes, is, indeed, sometimes subjected to inconvenience; but, in the case of imported goods, this inconvenience is reduced to a minimum by what is called the Warehousing System, under which, instead of paying the duty at the time of importation, he is only required to do so when he takes out the goods for consumption, which is seldom done until he has either actually found, or has the prospect of immediately finding, a purchaser.

The strongest objection, however, to raising the whole or the greater part of a large revenue by direct taxes, is the impossibility of assessing them fairly without a conscientious coöperation on the part of the contributors, not to be hoped for in the present low state of public morality. In the case of an income tax, we have already seen that unless it be found practicable to exempt savings altogether from the tax, the burthen cannot be apportioned with any tolerable approach to fairness upon those whose incomes are derived from business or professions; and this is in fact admitted by most of the advocates of direct taxation, who, I am afraid, generally get over the difficulty by leaving those classes untaxed, and confining their projected income tax to "realized property," in which form it certainly has the merit of being a very easy form of plunder. But enough has been said in condemnation of this expedient. We have seen, however, that a house tax is a form of direct taxation not liable to the same objections as an income tax, and indeed liable to as few objections of any kind as perhaps any of our

indirect taxes. But it would be impossible to raise, by a house tax alone, the greatest part of the revenue of Great Britain, without producing a very objectionable overcrowding of the population, through the strong motive which all persons would have to avoid the tax by restricting their house accommodation. Besides, even a house tax has inequalities, and consequent injustices; no tax is exempt from them, and it is neither just nor politic to make all the inequalities fall in the same places, by calling upon one tax to defray the whole or the chief part of the public expenditure. So much of the local taxation, in this country, being already in the form of a house tax, it is probable that ten millions a year would be fully as much as could beneficially be levied, through this medium, for general purposes.

A certain amount of revenue may, as we have seen, be obtained without injustice by a peculiar tax on rent. Besides the present land tax, and an equivalent for the revenue now derived from stamp duties on the conveyance of land, some further taxation might, I have contended, at some future period be imposed, to enable the state to participate in the progressive increase of the incomes of landlords from natural causes. Legacies and inheritances, we have also seen, ought to be subjected to taxation sufficient to yield a considerable revenue. With these taxes, and a house tax of suitable amount, we should, I think, have reached the prudent limits of direct taxation, save in a national emergency so urgent as to justify the government in disregarding the amount of inequality and unfairness which may ultimately be found inseparable from an income tax. The remainder of the revenue would have to be provided by taxes on consumption, and the question is, which of these are the least objectionable.

There are some forms of indirect taxation which must be peremptorily excluded. Taxes on commodities, for revenue purposes, must not operate as protecting duties, but must be levied impartially on every mode in which the articles can be obtained, whether produced in the country itself, or imported. An exclusion must also be put upon all taxes on the necessaries of life, or on the materials or instruments employed in producing those necessaries. Such taxes are always liable to encroach

on what should be left untaxed, the incomes barely sufficient for healthful existence; and on the most favorable supposition, namely, that wages rise to compensate the laborers for the tax, it operates as a peculiar tax on profits, which is at once unjust, and detrimental to national wealth. What remain are taxes on luxuries. And these have some properties which strongly recommend them. In the first place, they can never, by any possibility, touch those whose whole income is expended on necessaries; while they do reach those by whom what is required for necessaries, is expended on indulgences. In the next place, they operate in some cases as a useful, and the only useful, kind of sumptuary law. I disclaim all asceticism, and by no means wish to see discouraged, either by law or opinion, any indulgence (consistent with the means and obligations of the person using it) which is sought from a genuine inclination for, and enjoyment of, the thing itself; but a great portion of the expense of the higher and middle classes in most countries, and the greatest in this, is not incurred for the sake of the pleasure afforded by the things on which the money is spent, but from regard to opinion, and an idea that certain expenses are expected from them, as an appendage of station; and I cannot but think that expenditure of this sort is a most desirable subject of taxation. If taxation discourages it, some good is done, and if not, no harm; for in so far as taxes are levied on things which are desired and possessed from motives of this description, nobody is the worse for them. When a thing is bought not for its use but for its costliness, cheapness is no recommendation. As Sismondi remarks, the consequence of cheapening articles of vanity, is not that less is expended on such things, but that the buyers substitute for the cheapened article some other which is more costly, or a more elaborate quality of the same thing; and as the inferior quality answered the purpose of vanity equally well when it was equally expensive, a tax on the article is really paid by nobody: it is a creation of public revenue by which nobody loses.

In order to reduce as much as possible the inconveniences, and increase the advantages, incident to taxes on commodities, the following are the practical rules which suggest themselves. *1stly.* To raise as large a revenue as conveniently may be, from

those classes of luxuries which have most connection with vanity, and least with positive enjoyment; such as the more costly qualities of all kinds of personal equipment and ornament. *2dly.* Whenever possible, to demand the tax, not from the producer, but directly from the consumer, since when levied on the producer it raises the price always by more, and often by much more, than the mere amount of the tax. Most of the minor assessed taxes in this country are recommended by both these considerations.[1] But with regard to horses and carriages, as there are many persons to whom, from health or constitution, these are not so much luxuries as necessaries, the tax paid by those who have but one riding horse, or but one carriage, especially of the cheaper descriptions, should be low; while taxation should rise very rapidly with the number of horses and carriages, and with their costliness. *3rdly.* But as the only indirect taxes which yield a large revenue are those which fall on articles of universal or very general consumption, and as it is therefore necessary to have some taxes on real luxuries, that is, on things which afford pleasure in themselves, and are valued on that account rather than for their cost; these taxes should, if possible, be so adjusted as to fall with the same proportional weight on small, on moderate, and on large incomes. This is not an easy matter; since the things which are the subjects of the more productive taxes, are in proportion more largely consumed by the poorer members of the community than by the rich. Tea, coffee, sugar, tobacco, fermented drinks, can hardly be so taxed, that the poor shall not bear more than their due share of the burthen. Something might be done by making the duty on the superior qualities, which are used by the richer consumers, much higher in proportion to the value, (instead of, much lower, as is almost universally the practice under the present English system); but in some cases the difficulty of at all adjusting the duty to the value, so as to prevent evasion, is said, with what truth I know not, to be insuperable; so that it is thought necessary to levy the same fixed duty on all the qualities alike: a flagrant injustice to the poorer class of contributors, unless compensated by the existence of other taxes

[1] The assessed taxes were imposed upon houses, carriages, male servants, saddle and carriage horses, and race horses, and some other articles. — ED.

from which, as from the present income tax, they are altogether exempt. *4thly.* As far as is consistent with the preceding rules, taxation should rather be concentrated on a few articles than diffused over many, in order that the expenses of collection may be smaller, and that as few employments as possible may be burthensomely and vexatiously interfered with. *5thly.* Among luxuries of general consumption, taxation should by preference attach itself to stimulants, because these, though in themselves as legitimate indulgences as any others, are more liable than most others to be used in excess, so that the check to consumption, naturally arising from taxation, is on the whole better applied to them than to other things. *6thly.* As far as other considerations permit, taxation should be confined to imported articles, since these can be taxed with a less degree of vexatious interference, and with fewer incidental bad effects, than when a tax is levied on the field or on the workshop. Customs duties are, *cæteris paribus*, much less objectionable than excise: but they must be laid only on things which either cannot, or at least will not, be produced in the country itself; or else their production there must be prohibited (as in England is the case with tobacco) or subjected to an excise duty of equivalent amount. *7thly.* No tax ought to be kept so high as to furnish a motive to its evasion, too strong to be counteracted by ordinary means of prevention; and especially no commodity should be taxed so highly as to raise up a class of lawless characters, smugglers, illicit distillers, and the like.

Of the excise and customs duties lately existing in this country, all which are intrinsically unfit to form part of a good system of taxation, have, since the last reforms by Mr. Gladstone, been got rid of. Among these are all duties on ordinary articles of food,[1] whether for human beings or for cattle; those on timber, as falling on the materials of lodging, which is one of the necessaries of life; all duties on the metals, and on implements made of them; taxes on soap, which is a necessary of cleanliness, and on tallow, the material both of that and of some other necessaries; the tax on paper, an indispensable instrument of almost all business and of most kinds of instruction. The

[1] Except the shilling per quarter duty on corn, ostensibly for registration, and scarcely felt as a burthen.

duties which now yield nearly the whole of the customs and excise revenue, those on sugar, coffee, tea, wine, beer, spirits, and tobacco, are in themselves, where a large amount of revenue is necessary, extremely proper taxes; but at present grossly unjust, from the disproportionate weight with which they press on the poorer classes; and some of them (those on spirits and tobacco) are so high as to cause a considerable amount of smuggling. It is probable that most of these taxes might bear a great reduction without any material loss of revenue.

CHAPTER XVIII

THE CUSTOMS REVENUE OF THE UNITED STATES

66. The Financial Aspects of the Customs Revenue. — Dr. R. F. Hoxie discusses the financial aspects of our customs duties, as follows:[1]

A system of duties on imports for the support of the national government was established by the first Congressional revenue act under the Constitution of 1789. It seems to have been the popular desire, at that time, that customs duties alone should supply the federal revenue. But distrust, notably on the part of Hamilton, of the ability of this source to supply fully the fiscal needs of the government, led to the establishment also of a system of internal revenue duties. These two systems were on trial together for a decade. The result was definite. Though more than 88 per cent of the tax income was derived from import duties, that source continued to be regarded with favor by the people, while the internal revenue duties were steadily opposed. Nor was the opposition merely passive. In the case of the Whiskey Rebellion, it developed into armed resistance to federal authority, and, rapidly increasing in force, assumed at length the proportions of a national political issue. As such it accomplished a tax revolution. In the campaign of 1801 the maintenance of internal duties was one of the objections urged against Federalist rule. The triumph of the Republicans was immediately followed, as a political necessity, by the abolition of the internal taxes. This verdict of the people was final; it definitively established customs duties alone as the American system of national taxation. From that time until

[1] The Adequacy of the Customs Revenue, *Journal of Political Economy*, Vol. III, pp. 43–64. Reprinted with consent of the author and the *Journal of Political Economy.*

the end of the Civil War, resort was had to other forms of taxation "only on occasions of special exigency," marking the breakdown of the customs tax system.

Since the Civil War, indeed, the internal revenue duties imposed, during that emergency, to supplement the income from import duties have been in part retained, but with no intention of displacing the traditional American system. On the contrary that system has been constantly strengthened. The internal duties may be regarded as taxes of convenience, retained simply to bolster up the regular tax system. The fairly steady stream of income flowing from them reduces, to that extent, the amount of revenue to be derived from import duties. But in no way does it remove from the customs revenue system the responsibility for adequacy. Customs duties then, may, with propriety, be subjected to the test of adequacy, as the American system of taxation, from the tax revolution of 1802 to the present time.

It now remains, before entering upon the historical discussion, merely to indicate briefly the data necessary for the examination and the method of procedure. The most essential data for the inductive test about to be attempted are the figures of government expenditure, and of the income from customs duties in the United States, during the whole period under discussion. These figures have been collected and will be found in tables in the Appendix. Further, because of defects in the sources from which it was necessary to obtain these data, and also, because of the intimate relation existing between customs revenues and imports, the amounts of total and of dutiable imports have been added to the tables. For convenience in use all these figures have been incorporated into two charts (see below). In the first of these charts is represented the actual values of total imports and customs revenues from 1790 to 1893 inclusive, and the value of dutiable imports from 1821 to 1893. In the second chart is represented the per cent of customs revenues to net ordinary governmental expenditures from 1790 to 1893. It will be the aim of the following discussion to interpret these charts by the aid of the events of contemporaneous history; and the examination will be separated into several convenient parts, corresponding to the periods into which our history naturally

divides itself when viewed with reference to political and industrial conditions.

1. The years from the adoption of the Constitution of 1789 to the outbreak of the War of 1812 form a distinct period in the national and industrial development of the United States. The conditions were those of a young but vigorous agricultural and commercial nation subjected to strong foreign influence. The current national expenditure, though varying from year to year, was never excessive. Taxation was moderate, as proved by the general prosperity of the people and the rapid payment of the public debt. Under these conditions, the income from an efficient system of taxation, ought not to have violated to any great extent the principles of fiscal adequacy. A glance at Chart II, however, shows that throughout the period, and especially in the last decade when customs duties were the only source of public revenues, the income did seriously violate these principles. While the revenue was in the main much more than sufficient to supply current fiscal demands, its great and rapid fluctuations, when compared with government expenditures, rendered it an extremely variable basis upon which to place public finances. Chart I clearly shows the reason for this instability. Imports, upon the value of which customs revenues were dependent, reflected, not the demands of our government, but every marked change in European diplomacy and war.

Previous to the year 1802 the general state of European war had proved, in the main, advantageous to our commerce. Still the instability of customs revenues had been remarkable. Starting with a production in 1791, 41.5 per cent above the government expenditure, the income from this source fell the next year to more than 58 per cent below public expenditure, rose again in 1793 to 110.3 per cent, fell immediately to 76.2 per cent, and then rose with fluctuations violent but less extreme till, in 1802 when the internal duties were discarded, it stood at 155.9 per cent or more than three millions above the demand for current expenditure. The stability of public income was not increased by basing the national revenue system upon customs duties alone. The temporary cessation of hostilities in Europe in 1802 was accompanied by an immediate fall in the value of imports to $40,558,000 as compared with $64,720,000 in the

previous year. The renewal of European wars again produced a gradual increase of American commerce, until in 1807 the value of imports had risen higher than ever before, exceeding $78,000,000, while the revenue from customs duties was 89.6 per cent in excess of ordinary public expenditures. This surplus revenue, though in general indicating an unsound condition of the finances, did not prove burdensome to the treasury at the time, as an outlet for it was provided in the payment of the revolutionary war debt. The productiveness of taxation, therefore, gave rise to high expectations and led so conservative a financier as Mr. Gallatin to believe that the customs revenue system would prove an adequate basis in case of foreign war. In 1806 he raises the question whether some mode may not be devised to provide for the final and complete payment in a short period of the public debt. The next year he estimates that the surplus in the treasury at the end of 1808 will amount to $8,000,000, and that "an annual unappropriated surplus of at least $3,000,000 may henceforth be relied upon with great confidence." But in this he was quite misled. Already that series of events, foreign in origin, had commenced which, though not depriving the American people of the means for satisfying government needs, were destined speedily to all but annihilate American commerce and thus cut off from the government its source of supply. The Berlin and Milan decrees of Napoleon, followed by the British orders in council, the expiration of Jay's treaty, and Jefferson's unfortunate imposition of the embargo brought about an immediate falling off in the volume of American imports from $78,856,000 in 1807 to $43,992,000 in 1808 and $38,602,000 in 1809. The suspension of commerce meant the impairment of the revenue from customs duties. From 1807 to 1809 the income from this source fell from $15,845,000, or 89.6 per cent more than was called for by current government needs, to $7,257,000, a little more than 70 per cent of the government expenditures. The surplus for which Mr. Gallatin had been seeking employment was immediately swept away. In his report for 1808 the secretary's tone has entirely changed. "If the embargo and the suspension of commerce shall be continued," he writes, "the revenue arising from commerce will in a short time entirely disappear. In case of war some part of

that revenue will remain; but it will be absorbed by the increase of public expenditures. In either case, new resources to an unascertained amount must be resorted to." From this time to the end of the period in 1812 a series of rapid changes in the aspect of foreign affairs was faithfully reflected by fluctuations in the source of revenue. In 1808 England opened the ports of Spain and Portugal, and early in 1809 the embargo was suspended—importations responded in 1810 by a rise from $38,602,000 to $61,008,000. Napoleon, in 1810, seized the American shipping in European ports, and the embargo was reënforced in the same year as regarded England—importations fell in 1811 to $37,377,000. Shortly after, Russia and Sweden opened their ports to American shipping in defiance of the Berlin and Milan decrees—imports rose rapidly to $68,534,000.

A more comprehensive idea of this period may perhaps be obtained from an examination of the charts and tables than from the previous discussion. But such an examination serves only to strengthen the evidence revealing the inadequacy of the customs revenue system. From Chart II it will be seen that in the twenty-one years here included, though the revenue was on the whole much above government expenditure, yet it fell below that amount no less than nine times—a most remarkable exhibition of instability. Further, after 1802, when customs became the sole source of revenue, the public income, as shown by the tables, ranged from 30 per cent below to 89 per cent above expenditures; yet in one year only did it approach nearer than 27 per cent above or below that amount. In a word, the revenue seemed utterly uncontrollable either by reduction when it was too large or by increase when it was too small. Taken as a whole, then, the examination of this period indicates clearly that when the commerce of a nation is exposed to serious disturbances, on account of foreign influence, great instability in the revenue derived from this source is the inevitable consequence, and disordered finances the result. Under such circumstances it must be extremely dangerous to base the public finances upon customs duties alone.

2. With little change in industrial conditions, the United States passed from the period of foreign influence into a period

of foreign war. Peace was formally abrogated at about the close of the fiscal year 1812, and normal conditions were not restored until near the end of the fiscal year 1816. Roughly speaking, these dates mark the limits of the war period. Were it reasonable, during this time, to judge of the adequacy of the customs revenue system by means of a simple comparison between the income from import duties and the necessary expenditures of the government, no elaborate discussion would be necessary in order to reach a very definite conclusion. The great depression of the broken line on Chart II clearly and conclusively indicates the utter failure of the customs revenue to support the government adequately. It must be borne in mind, however, that this period was a crisis in the life of the nation when it may be doubted whether the current national income was sufficient to satisfy both the total wants of the government and the imperative individual needs of the people. No tax system in such a case could be required to furnish the whole of the necessary government income.

This fact was recognized at the time, and influenced the financial plan of the war. Mr. Gallatin, secretary of the treasury, in outlining this plan, calculated that taxation might be safely depended upon to defray the ordinary expenses of the peace establishment, together with the interest on the public debt, and that, with this tax income as a basis, the extraordinary expenses might be defrayed by loans, without injury to the credit of the nation. In pursuit of this policy, he proposed that the whole of the tax income should, as heretofore, be drawn from customs duties. These calculations seem to have been reasonable. Imports, though varying, had risen in 1812 to more than $68,000,000 — an ample source from which to obtain the peace revenue — while there was an abundance of loanable capital in the country.[1] The war policy, then, was rational. Further, it was conditioned on the character of the revenue from customs duties. Unless, therefore, it can be shown that the nation was exhausted or the people disaffected, the adequacy of the customs

[1] In 1808 Mr. Gallatin said: "The embargo has brought in and kept in the United States almost all the floating capital of the nation, . . . at no former time has there been so much redundant and unemployed capital in the country." — *Report of the Secretary of the Treasury*, 1808, *Finance Reports*, Vol. I, p. 377.

revenue system during this period is to be judged by the success of the war policy.

From the outset, the financial operations of the war were inadequately supported by the tax revenue. In accordance with his plan Mr. Gallatin had recommended that customs be immediately increased 100 per cent. June 30, 1812, therefore, duties were doubled, but the anticipated increase of revenue was not forthcoming. The income was, indeed, larger for the calendar year 1813 than in the years preceding, owing to the great amount of imports in 1812, but it fell immediately thereafter far below the peace level, and during the continuance of the war remained utterly insufficient and wholly inflexible. Nor could the result have been otherwise. For the amount of imports progressively fell as public expenditure rose, until, in 1815, the total value of imported merchandise was less than the ordinary income from customs duties, and not one third of the amount of public expenditures. The credit of the government declined almost from the beginning. Of the six government loans only the first was placed at par, though 6 per cent was offered and various tempting inducements held out to capitalists. The depreciation of the public credit is shown in the discount of 35 per cent at which 6 per cent stock was sold in 1814. The successive issues of treasury notes which were resorted to after the fiscal year 1813 also suffered severe depreciation. By 1815, so low had the credit of the nation fallen, that payments in state bank paper, though the banks had suspended specie payment, were universally preferred to payments in the paper of the government.

The failure of the customs revenue system to produce an abundant revenue, and this consequent deplorable state of the public finances, were not due to national exhaustion. The resources of the country were ample, but they could not be reached through the channel of customs duties. Nor, in spite of the opposition of New England, can the fall of public credit be ascribed to the unwillingness of the people to bear further taxation. Secretary Campbell distinctly denied both suppositions, and his denial is borne out by the fact that the internal duties, reluctantly placed when it became evident that the customs revenue system had broken down, produced a fairly abundant income up to the end of the period. No valid excuse, then,

for the insufficiency of the public revenue being found in the want of public wealth or the popular support of the government, it must follow that the failure of the financial plan of the war, conditioned as it was upon customs duties, is evidence of the inadequacy of that system of taxation to serve as the source of national income.

The evidence against the customs revenue system furnished by this period is not, moreover, all brought out in the discussion of the failure of the war policy. The instability of the revenue from import duties was, further, most strikingly illustrated by the events following the close of the war. As soon as the artificial restraints on foreign intercourse were removed, the volume of imports rose to a great height. In 1815 the value of imported merchandise stood at only $10,645,000; the next year it was $129,964,000, more than a twelvefold advance. The 100 per cent increase in the rate of customs duties, now that the imperative need for it was past, now that it was too late to save the credit of the nation, became enormously productive. For the year 1816 the customs revenue was five times greater than for 1815, while in 1816 and 1817, together, $63,589,000 flowed into the treasury from import duties, as against $13,280,000 in the two years preceding. This remarkable increase of revenue, coming so near the close of the war and yet causing no stay in the progress of the nation, is indicative of the tax income that should have been realized while the war was actually in progress. Had the $63,000,000 of revenue now received from customs duties been distributed over the three or four preceding years there is every reason to believe that the war might have been more vigorously prosecuted, the credit of the government sustained, and much less public debt incurred.

3. Oppressive foreign influence in the United States disappeared with the War of 1812. A new era was then entered upon, characterized chiefly by vigorous and healthful national growth, the payment of the public indebtedness, and the rise of manufactures. The limits of this period, as distinctly shown in Chart I, are 1816 to 1835. For the purposes of this paper the leading events may be very briefly summarized.

Though foreign trade declined rapidly after 1816, customs revenues were in the main more than sufficient to meet govern-

ment expenditures. The evils of redundant income were avoided by the rapid payment of the public debt. Unfavorable industrial conditions, however, in this manufacturing era, as in the commercial and war periods preceding, rendered the revenue extremely uncertain. Especially in the crises of 1819 and 1824 the income, as shown in Chart I, fluctuated abruptly and widely about government needs. During the earlier crisis these fluctuations were almost as marked as those of the foreign war period. Chart I shows the cause. Imports which had risen in 1818 to $102,323,000 fell successively, through 1819, 1820, and 1821, to $67,959,000, $56,441,000, and $43,696,000 respectively. Customs revenues consequently decreased, falling from $20,283,000, in 1819, to $15,005,000, in 1820, and $13,004,000 in 1821. Nor did the income fully recover until after the crisis of 1824. The serious effect upon the treasury of this unexpected decrease of revenue is shown by the following extract from the report of the secretary for 1819: "It is not probable that any modification of the existing tariff can supersede the necessity of resorting to internal taxation if the expenditure is not diminished. . . . Whether the revenue be augmented or expenditure be diminished a loan to some extent will be necessary." Yet the revenue was ordinarily redundant and two years before had been 31.4 per cent greater than the government expenditures, and further, this was in a time of peace and average prosperity, when, if ever, the income should have proved adequate. However, from the crisis of 1824 to the end of this period in 1835 little criticism can be made of the revenue system. Imports rose rapidly, and the income from customs duties continued to be for the most part far above the current government expenditures. Though this was in direct violation of the rule of sufficiency it furnished a welcome means of debt payment, and the period closed with confidence in this source of revenue unshaken.

4. Between 1835 and 1843 a brief period of unhealthful speculative expansion, and the inevitably painful return to normal conditions, succeeded the vigorous growth of the preceding years. The national debt was practically liquidated at the close of the year 1835, and the speculative spirit which developed was undoubtedly due in great part to surplus revenue no longer to be disposed of by debt payment. This surplus, accumulated mainly

through excessive sales of public lands, added to the ordinary customs tax income.

An unappropriated surplus is always a greater financial evil than a moderate deficit, since it so far unnecessarily reduces the income of the people and leads to false estimates of the taxpaying capacity of the nation. At this time, therefore, the income from a legitimate system of taxation, through its elasticity, should have declined so that the total government income might meet exactly the demands of ordinary public expenditures. It was not so with the income from the customs tax system. Though the secretary of the treasury recognized the danger and repeatedly endeavored to bring about a reduction in the tax income, the revenue from customs during the years of speculation rapidly increased (see Chart I), rising from $16,214,000, in 1834, to $19,391,000, in 1835, and $23,409,000, in 1836. The ridiculous spectacle was presented of a sovereign people taxing themselves far beyond the needs of the government and yet wholly unable to obtain relief, while a growing surplus was becoming more and more a source of anxiety. At last, in June, 1836, the reduction of the revenue being out of question, Congress passed an act for the disposal of the surplus. It ordered the distribution of $28,000,000 among the states in the form of quarterly payments beginning January 1, 1837. Before the last deposit was made the aspect of affairs was entirely changed. Over-speculation had precipitated the crisis of 1837. The sale of public lands ceased. Government income at once fell from forty-eight to nineteen millions. The same secretary, who, a year before, had urged a reduction of income now spoke dolefully of a prospective deficit at the beginning of 1838 of over five millions. The need now was for an immediate increase of the tax revenue. But the income from the customs tax system instead of rising to meet this need dropped from $23,409,000 to $11,169,000. A glance at Chart II will best indicate the state of affairs. Though two years before, when the treasury was overflowing with income from an incidental source, import duties had furnished 10.3 per cent more than the total needs of the government, they now brought in less than 30 per cent of necessary government expenditures. Secretary Woodbury, commenting upon the situation, said: "It is impossible, . . .

that, with sources of revenue so fluctuating as ours, and so dependent on commercial prosperity, any fiscal operations should be long continued with ease, vigor, and uniformity, without some such regulator as a power to issue and redeem treasury notes, or to invest and sell the investment of surpluses. By any other course we should constantly be exposed to great deficiencies or excesses with all their attendant embarrassments."

Frequent though less severe fluctuations in the customs revenue continued in the troubled years succeeding the crisis, nor did it again meet government demands till after the close of the period in 1843. This condition of affairs called forth from the secretary in 1839 the following complaint: "The principal sources of our revenue are sensibly affected by fluctuations, not only in commercial prosperity, but in the crops, the banking policy, and the credit systems of even foreign nations. The influence of these causes seems to become yearly more changeable and uncertain in its extent." National finances in consequence were most seriously affected. It was found necessary to create a new national debt. Two loans and five issues of treasury notes were resorted to between 1837 and 1843, while the credit of the government "stood at a lower ebb than ever before in times of peace." The examination of this period of speculative expansion and collapse furnishes then a double exhibition of utter inflexibility of the customs tax system, when it should have been most flexible, and of extreme sensitiveness to changes in commercial and industrial conditions, when it should have been most stable.

5. The two decades following 1843 form another period of vigorous national growth accompanied by remarkable commercial activity. Reference to Chart I shows the rapid and enormous increase of foreign trade. Imports rose from $96,390,000 in 1844 to $336,282,000 in 1860. Mr. Walker speaks of 1846 as beginning a "new commercial era" in which "many causes combined to augment the trade among nations." The Mexican War and the crisis of 1857 were the only events which, in twenty years, seriously interfered with industrial prosperity. The demands of the government were at no time beyond the revenue that could have been obtained from legitimate taxation, while more than ordinary efforts were made to bring the tax income

into exact conformity with public expenditures. A most favorable opportunity therefore existed to test the adequacy of the customs revenue system.

The financial history of the period, however, while it reveals a closer conformity of the tax income to the demands of the government than previously, does not present the customs system in a favorable light. A high rate of specific duties had been levied in 1842 to enable the income to recover from the effects of the crisis of 1837. The first result was an increase considerably beyond government needs. By 1845 customs duties were producing 19.4 per cent more revenue than was called for by public expenditures. Then, though imports continued to increase, the income began seriously to decline. Mr. Walker, secretary of the treasury, declared that this decline "rose from the prohibitory character of specific duties," and that "the revenue under the tariff of 1842 must have continued to sink so rapidly as soon to have caused a great deficit, even though in time of peace, and thus have required ultimately a resort to direct taxes or excises."

As high specific duties had failed to produce adequate revenues, the secretary proposed a reduction, with *ad valorem* duties. Congress therefore enacted a revenue law along these lines, designed to aid in vigorously carrying on the war with Mexico. But though the revenue from customs was thus increased, it fell far short of satisfying government needs during and immediately following the war. Only 43.2 per cent of the necessary public income was received from such taxation in 1847, 66.6 per cent in 1848, and 65 per cent in 1849. With the year 1850, however, the income began to increase rapidly,[1] and by 1853 "a large surplus accumulated in the treasury and became a cause of alarm in commercial circles." Expenditures increased, but still the surplus grew. Alarm was felt that the accumulation of specie in the treasury might bring on financial stringency. An act was therefore passed, in 1857, reducing customs duties. This attempt to bring about an equilibrium of income and expenditure, like previous efforts, miscarried. It was impossible to reckon on the certainty of customs revenues. The crisis of 1857 brought with

[1] Not so rapidly as appears from the tables (see Appendix I). Before 1850 customs revenues are net — after 1850, gross.

it an immediate fall in the tax income of over $22,000,000. Before the end of the year 1857 Congress was obliged to authorize an issue of $23,716,300 in treasury notes and six months later to place a loan of $10,000,000. During the remainder of this period the receipts remained inadequate, exhibiting extreme sensitiveness to the political movements preceding the Civil War. A threatened revolution of a political character late in 1860 drew the following complaint from the secretary of the treasury: "Already has the treasury been seriously affected by these causes. The receipts from customs for the last few days have greatly fallen off, and the limited amount received is composed each day of an increased proportion of treasury notes not yet due." Thus with an income insufficient even in time of peace and prosperity, the country entered upon a period of civil war.

6. Though on a vastly greater scale, the financial conditions and results of the Civil War were quite similar in character to those of the War of 1812. A very brief discussion of the later period will therefore suffice for the purposes of this paper. If, in the Civil War as in the War of 1812, the income from customs duties be contrasted with government expenditures, the result is even more unfavorable to this form of revenue. This is readily seen by a glance at Chart II and by a comparison of the following tables:

WAR OF 1812

(,000 omitted)

Year	Government Expenditures	Customs Revenues	Per Cent of Customs Revenues to Government Expenditures	Value of Imports
1810 . .	$8,474	$8,583	101.2	$61,008
1811 . .	8,178	13,313	162.7	37,377
1812 . .	20,280	8,958	44.1	68,534
1813 . .	31,681	13,224	41.4	19,157
1814 . .	34,720	5,998	17.2	12,819
1815 . .	32,943	7,282	22.1	10,645
1816 . .	32,196	36,306	112.7	129,964
1817 . .	19,990	26,283	131.4	79,891

CIVIL WAR

(,000 omitted)

Year	Government Expenditures	Customs Revenues	Per Cent of Customs Revenues to Government Expenditures	Value of Imports
1860 . .	$63,200	$53,187	84.1	$336,282
1861 . .	66,650	39,582	59.3	274,656
1862 . .	469,570	49,056	10.4	178,330
1863 . .	718,734	69,059	9.6	225,375
1864 . .	864,969	102,316	11.8	301,113
1865 . .	1,296,817	84,928	6.5	209,656
1866 . .	523,565	179,046	32.2	423,470
1867 . .	357,542	176,417	49.3	378,158
1868 . .	377,340	164,464	43.5	344,808
1869 . .	322,865	180,048	55.7	394,440

In the Civil War, however, as in the War of 1812, it was believed to be impossible to obtain the whole of the necessary government revenues by means of taxation. The financial plan of the war, as detailed by the secretary of the treasury, provided that the bulk of extraordinary income should be drawn from loans, taxation being relied upon to furnish only the means for the discharge of the ordinary demands, for the punctual payment of interest on loans, and for the creation of a gradually increasing fund for the reduction of the principal. Such a tax revenue, it was confidently expected, would maintain the credit of the nation unimpaired. "The preference always evinced by the people of the United States, as well as their legislature and executive, for duties on imports" determined the secretary, when making provision for the necessary tax income, to recommend only such modifications of the existing tariff as would produce the principal part of the needed revenue, and such resort to direct taxes or internal revenue duties or excises as circumstances might require in order to make good whatever deficiency might be found to exist. Customs duties were then distinctly regarded as the war taxes, and the success of the war policy is the test of their adequacy.

From the beginning of the struggle the capacity of the cus-

toms revenue system was strained to the utmost. Additional import duties were imposed during the extra session of Congress in the summer of 1861. A further increase was made in December, soon after the next regular session had convened, and "from that time till 1865 no session, indeed, hardly a month of any session, passed in which some increase of duties on imports was not made." The results were ridiculously meager. For the years 1861–62–63 the revenue remained almost absolutely inflexible, scarcely rising above the ordinary peace level. As early as 1863 Secretary Chase was forced to admit the failure of the policy of relying on customs revenues. In his report he said: "It is possible that a limited additional amount of income may be derived from judicious modifications of some provisions of the laws imposing duties on foreign imports, but the chief reliance for any substantial increase, and even for the prevention of possible decrease, must be on internal duties." Nevertheless a supreme effort was made in the great act of 1864 to bring about a substantial increase in the customs revenue. Imports were universally taxed, and at the highest rates that Congress dared impose. The result was disappointing, and was a remarkable illustration, both of the inflexibility and the instability of the customs system. The excessive rates caused an immediate reduction of imports, and, instead of an increase, there was a fall in the amount of customs revenue, for 1865, of more than seventeen millions of dollars.

In consequence of the meager income from taxation, the credit of the government early began to decline. Though all loans were nominally placed at not less than par, it was par in depreciated paper currency. The following table exhibits the rapid fall of public credit by showing the specie price of all obligations issued during the war:

For the Years Ending	Gross Receipts from Debts Created	Gold Value of Gross Receipts	Percentage Realized
December 31, 1862 . . .	$470,562,306	$420,657,784	89.39
" 31, 1863 . . .	663,748,162	451,687,251	68.05
" 31, 1864 . . .	754,938,393	384,462,432	50.93
September 30, 1865 . . .	675,984,729	438,540,163	64.87

The spectacle of a powerful and wealthy nation placing its loans at a discount of almost 50 per cent is strong evidence against its system of taxation.

Though condemned by the failure of the war policy, the actual inferiority exhibited by the customs system in this emergency can be best shown by a comparison of the revenue received from it with that derived from internal revenue duties. The internal revenue system was only gradually put in operation after the beginning of the war, and first became productive in 1863. In the next three years, however, $628,436,000 were covered into the treasury from this source as against $336,290,000 from the customs tax system pushed to its greatest capacity. At the period of greatest stress, when the revenue from customs duties stood absolutely inflexible, the revenue from internal duties, though already greater than that from imports, was made to increase $100,000,000 in a single year. Further, while the income from customs was extremely uncertain, the flow of revenue from internal duties was a steadily rising stream, increasing from $109,000,000 in 1864 to $209,000,000 in 1865, and $309,000,000 in 1866.[1] It is true, indeed, that after the stress of war was passed, customs duties furnished an enormously increased revenue, but quickness of response to financial measures is an absolute essential to adequacy. Here lay the chief merit of the internal revenue system. Its manifest superiority over the customs system goes only to confirm the conclusions reached by the comparison of the two systems in the War of 1812. It is probable, as H. C. Adams suggests, that had the internal revenue machinery been in operation two years earlier the war might have been brought to a more speedy termination, while the credit of the government could not have suffered as it did.

7. The Civil War period financially considered closed about the year 1869, when the government ceased to borrow to satisfy the demands incurred on account of the war. The succeeding years down to the present time form a period in which the general conditions were nearly the same in character as those following the War of 1812. In this as in the former period, commercial, industrial, and national expansion followed

[1] Allowance must be made, however, for the fact that internal revenue duties were payable in depreciated paper currency.

the war; in this period also these manifestations of growth were accompanied by serious industrial disturbances; in both periods a great national debt was saddled on the government. The financial history of the two periods is, naturally, quite similar. One great difference, however, exists. The internal revenue duties, which were abolished as soon as possible after the War of 1812, were, in the later period, in part retained. From them the government has received a fairly steady and abundant revenue in addition to the income from customs duties. This fact may perhaps be taken as cause for denying the possibility of testing, by means of the fiscal criteria, the adequacy in this period of the customs revenue system. But the objection seems really without foundation. Customs duties are still regarded as the traditional, national system of taxation. They are only supplemented by the internal duties; but this fact is, in itself, highly significant. That it has been deemed necessary in recent years thus to bolster up the customs system is, *per se*, one of the strongest proofs of the failure of that system to serve as an adequate source of national revenue. It will be admitted, however, that the employment of the internal duties does render a direct comparison between customs revenues and public expenditures useless for the purposes of this paper. Yet a brief survey of the period is of great value to bring out two points — the over-abundance and inflexibility of customs revenues in a period of general prosperity, and, at the same time, the extreme instability of the income from this source.

At the beginning of this period speculative activity grew rapidly, commerce was greatly stimulated, and the tax income was in consequence remarkably large. As early as 1870, the revenue was more than $100,000,000 greater than current public expenditures, and the next year the excess was nearly as great. The public debt, though payments were made rapidly, could not absorb so great a surplus. It became a menace to the prosperity of the nation. An immediate reduction of taxation was therefore called for, and in 1872 a reduction of 10 per cent in the rate of customs duties was effected. But on account of the instability of the revenue the step proved disastrous. Crisis and industrial depression almost immediately followed, and both imports and customs duties were suddenly and extensively

decreased. Imports fell nearly $100,000,000 in a single year and did not rise again to their normal volume until 1880. The revenue from customs which had stood at $216,370,000 in 1872 dropped to $188,089,000 in 1873 and $163,103,000 in 1874. Then it became necessary for the government, which but three years before was contending with a $100,000,000 annual surplus, to resort to borrowing. In alarm, Congress, in 1875, restored the 10 per cent which had been taken from the rates of customs duties in 1872. But the revenue system which had proved so sensitive to commercial changes, did not respond to the effort of the government. The fall in the value of customs revenues continued until in 1878 it was $86,000,000 less than five years before.

The revival of trade, however, which came about 1879, soon carried customs revenues to a higher point than ever before. By 1881 the secretary of the treasury was again complaining of an embarrassing surplus revenue. This was estimated, in 1883, at $85,000,000 per annum, and in 1886 Secretary Manning reported that during the last years the surplus had averaged over $100,000,000. How to dispose of the immense hoard in the treasury became again the great financial problem. Congress had risked revenue reduction with disastrous results. It dared not again adopt this means of avoiding surplus. Naturally,[1] therefore, it now resorted to the other alternative — extravagant expenditure. By means of enormous appropriations the surplus was soon depleted. But here again Congress had failed to take sufficient account of the instability of the customs revenue system. The crisis of 1893 was at hand; the revenue from customs fell rapidly; a deficit resulted, and the government has again been forced in a time of peace to make use of its credit. Thus the nation is repeating, apparently in the same order as before, the financial experiences of the earlier part of the period; and the dreary alternative of embarrassing surplus and embarrassing deficit bids fair to continue as long as the present revenue system exists.

[1] As Secretary Cobb has said: "When public revenues *happen* to be abundant, many projects are listened to and adopted by Congress, without careful regard to the burdens they may permanently impose." — *Report of the Secretary of the Treasury*, 1857, p. 10.

The direct historical examination of the customs revenue system, in connection with the fiscal criteria previously laid down, has now been completed. This examination has extended over the whole experience of the United States in the use of the customs revenue system as a national source of income. No period, therefore, remains whose events may contradict the conclusions drawn from this study so far as they relate to American financial history. It will be well briefly to sum up the results of this discussion.

In the historical survey a variety of national, industrial, and commercial conditions have been encountered, yet the testimony throughout is strikingly in accord. In the first period examined, while the nation was yet in its youth, and subject to strong foreign influences, the customs revenue, though on the whole abundant, was found to be uncertain to such an extent as rendered it an extremely precarious base on which to place the public finances. In the second period, under the stress of foreign war, the financial policy based upon the customs revenue system utterly broke down, as a result of the insufficiency and inelasticity of this form of income. The generally favorable conditions of the third period, while accompanied by a redundancy of revenue, did not insure the nation against great instability of income, resulting from transient industrial disturbances. The fourth period under examination furnished a striking illustration of redundant customs revenue both as effect and cause of speculative expansion, and of the extreme instability of this form of revenue in time of acute commercial crisis. In the fifth period, under remarkably favorable general circumstances, the customs revenue, though on the whole abundant, still proved extremely sensitive to industrial and commercial disturbances. The Civil War period served only to illustrate on a larger scale the defects of the system that were found to characterize it in the War of 1812. And finally, in the full vigor of the nation, and in time of average prosperity, this form of revenue was found to be alternately, according to the transient character of industrial and commercial conditions, greatly in excess of and far beneath the income necessary for the support of the financial operations of the government.

It will be seen that two factors are common to all these periods,

viz. redundancy of revenue in time of commercial and industrial activity, and insufficiency and instability of revenue in time of stress and depression. On the whole it may be asserted, without fear of contradiction, that, throughout the history of the customs revenue system in the United States, the income from this source has been determined, not by government need, but, almost wholly, by the character of temporary industrial and, more especially, temporary commercial conditions. As a consequence, in war the current public income has proved utterly insufficient, unstable, and inflexible; in peace it has shown itself extremely uncertain, fluctuating with every crisis and even with the changes in the policy and condition of foreign nations; in times of prosperity it has forced upon the treasury embarrassing surpluses, leading to extravagant expenditure, speculation, and crisis; in adversity it has left the treasury empty, necessitating the lavish use of the public credit.

APPENDIX TO CHAPTER XVIII

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1791	$28,687	—	$3,107	$4,399	141.5
1792	29,746	—	8,269	3,343	41.6
1793	28,990	—	3,846	4,255	110.3
1794	28,073	—	6,297	4,801	76.2
1795	61,266	—	7,309	5,588	76.6
1796	55,136	—	5,790	6,567	113.4
1797	48,379	—	6,008	7,549	125.6
1798	35,551	—	7,607	7,106	93.4
1799	33,546	—	9,295	6,610	71.1
1800	52,121	—	10,813	9,080	83.9
1801	64,720	—	9,393	10,750	114.4
1802	40,558	—	7,976	12,438	155.9
1803	51,072	—	7,952	10,479	131.7
1804	48,768	—	8,637	11,098	127.3
1805	67,420	—	9,014	12,936	143.5
1806	69,126	—	9,449	14,667	155.2
1807	78,856	—	8,354	15,845	189.6
1808	43,992	—	9,061	16,363	180.5
1809	38,602	—	10,280	7,257	70.5
1810	61,008	—	8,474	8,583	101.2
1811	37,377	—	8,178	13,313	162.7
1812	68,534	—	20,280	8,958	44.1
1813	19,157	—	31,681	13,224	41.4
1814	12,819	—	34,720	5,998	17.2
1815	106,457	—	32,943	7,282	22.1
1816	129,964	—	32,196	36,306	112.7
1817	79,891	—	19,990	26,283	131.4
1818	102,323	—	20,018	17,176	85.2
1819	67,959	—	21,522	20,283	94.2
1820	56,441	—	18,285	15,005	82.0
1821	43,696	$41,965	15,849	13,004	82.5
1822	68,395	64,841	15,000	17,589	117.2

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893 (*Continued*)

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1823	$51,310	$48,684	$14,706	$19,088	129.7
1824	53,846	50,763	20,273	17,878	88.1
1825	66,395	62,687	15,857	20,098	126.7
1826	57,652	53,002	17,037	23,341	137.0
1827	54,901	52,010	16,139	19,712	122.1
1828	66,975	62,963	16,394	23,205	141.5
1829	54,741	51,259	15,184	22,681	142.7
1830	49,575	46,063	15,142	21,922	144.7
1831	82,808	77,300	15,237	24,224	158.9
1832	75,327	68,330	17,288	28,465	164.6
1833	83,470	63,258	23,017	29,032	126.1
1834	86,973	47,248	18,627	16,214	87.0
1835	122,007	64,211	17,572	19,391	110.3
1836	158,811	88,690	30,868	23,409	75.8
1837	113,310	62,333	37,243	11,169	29.9
1838	86,552	48,391	33,864	16,158	47.7
1839	145,870	80,682	26,896	23,137	85.6
1840	86,250	44,139	24,314	13,499	55.5
1841	114,776	57,698	26,481	14,487	54.7
1842	87,996	64,650	25,134	18,187	72.3
1843	37,294	25,722	11,780	7,046	59.8
1844	96,390	79,705	22,483	26,183	116.4
1845	105,599	89,934	22,954	27,528	119.4
1846	110,048	91,401	27,261	26,712	97.9
1847	116,257	100,419	54,920	23,747	43.2
1848	140,651	125,705	47,618	31,757	66.6
1849	132,565	118,854	43,581	28,346	65.0
1850	164,034	148,051	40,948	39,668	96.8
1851	200,476	182,565	47,821	49,017	102.5
1852	195,387	173,737	44,560	47,339	106.2
1853	250,157	225,424	48,164	58,931	122.3
1854	276,088	253,535	57,916	64,224	110.8
1855	231,650	201,736	59,502	53,025	89.1
1856	295,650	246,047	69,111	64,022	92.6
1857	333,511	283,569	67,997	63,875	93.9
1858	242,678	187,385	74,556	41,789	56.0
1859	316,823	249,966	68,993	49,565	71.8

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893 (*Continued*)

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1860	$336,282	$267,891	$63,200	$53,187	84.1
1861	274,656	207,235	66,650	39,582	59.3
1862	178,330	128,487	469,570	49,056	10.4
1863	225,375	195,348	718,734	69,059	9.6
1864	301,113	262,950	864,969	102,316	11.8
1865	209,656	169,559	1,296,817	84,928	6.5
1866	423,470	366,349	523,565	179,046	32.2
1867	378,158	361,125	357,542	176,417	49.3
1868	344,808	329,661	377,340	164,464	43.5
1869	394,440	372,756	322,865	180,048	55.7
1870	426,346	406,131	309,653	194,538	62.8
1871	500,216	459,597	292,177	206,270	70.6
1872	560,419	512,735	277,517	216,370	77.9
1873	663,146	484,746	290,345	188,089	64.7
1874	567,443	414,748	302,633	163,103	53.8
1875	526,260	379,795	274,623	157,167	56.5
1876	464,586	324,024	265,101	148,071	55.8
1877	439,829	298,989	241,334	130,956	54.2
1878	438,422	297,083	236,964	130,170	54.9
1879	439,292	296,742	266,947	137,250	51.4
1880	627,555	419,506	267,642	186,522	69.6
1881	650,619	448,061	260,712	198,159	72.0
1882	716,213	505,491	257,981	220,410	85.0
1883	700,829	493,916	265,408	214,706	80.8
1884	667,575	456,295	244,126	195,067	79.9
1885	579,580	386,667	260,226	181,471	69.7
1886	625,308	413,778	242,483	192,905	79.5
1887	683,418	450,325	267,932	217,286	81.0
1888	712,248	468,143	297,924	219,091	81.7
1889	741,431	484,856	299,288	223,832	74.7
1890	773,674	507,571	318,040	229,668	72.2
1891	854,519	466,455	365,774	219,522	60.0
1892	813,601	355,526	345,023	177,452	51.4
1893	844,454	400,282	383,478	203,355	53.0

(The figures for the next eleven years, stated in millions of dollars, were as follows:

Year	Total Imports	Dutiable Imports	Expenditures	Customs Revenues
1894	636.6	257.6	367.5	131.8
1895	731.2	354.3	356.2	152.2
1896	759.7	390.8	352.2	160.0
1897	789.3	407.3	365.8	176.5
1898	587.2	295.6	443.4	149.6
1899	685.4	385.8	605.1	206.1
1900	830.5	463.8	520.9	233.2
1901	807.8	468.7	524.6	238.6
1902	899.8	503.3	485.2	254.4
1903	1007.9	570.7	517.0	284.5
1904	981.8	527.7	583.7	261.3

— Ed.)

CHAPTER XIX

THE INTERNAL REVENUE SYSTEM OF THE UNITED STATES

67. The Taxation of Spirits (1862–1870). — The Civil War compelled our national government to create a most extensive and complicated system of internal taxes, — upon incomes, upon commodities, upon transactions. Of the war taxes upon commodities none had a more interesting or instructive history than that upon distilled spirits, the history of which was thus narrated by Mr. David A. Wells:[1]

Previous to the war the manufacture of spirits was free from all specific taxation or supervision by either the national or state governments; and being produced mainly from Indian corn, at places adjacent to the localities where this cereal was cultivated, was afforded at a very low price — the average market price in New York for the five years preceding the year 1862 having been 24 cents per proof gallon; with a minimum price during the same time of 14 cents per gallon. The price of alcohol during the same period ranged from 45 to 65 cents per gallon. Under such circumstances the consumption of spirits, for a great variety of purposes, in the United States previous to the war had become enormous; the estimated product for the year 1860 having been in excess of 90,000,000 of gallons; while the maximum quantity exported in any one year was not in excess of 3,000,000 of gallons. One of the purposes for which this product of spirits was extensively used at this time, which was previous to the discovery and use of petroleum, was the manufacture of "burning fluid" — an illuminating agent composed

[1] David A. Wells, The Recent Financial, Industrial, and Commercial Experiences of the United States. Cobden Club Essays, second series. Reprinted, New York, 1872.

of one part of rectified spirits of turpentine, mixed with from four to five parts of alcohol; and so extensive was the manufacture and consumption of this article, that it was stated on the floor of Congress in 1864 that in the city of Cincinnati alone the amount of alcohol required every twenty-four hours for this industry was equivalent to the distillate of 12,000 bushels of corn. The excessive cheapness of alcohol also led to most extensive use of it for fuel in domestic culinary operations, for bathing and cleaning, for the manufacture of varnishes and patent medicines, and for a great variety of other purposes. It is also to be noted that nearly all preparations and washes for the hair, which at that time in other countries — as now universally — were prepared almost exclusively on a basis of fats and oils, were in the United States then composed almost wholly on a basis of alcohol; the comparative difference in the price of this article in the United States and Europe giving an entirely different composition to products of large consumption intended to effect a common object.

The immediate effect of the imposition and continued increase of internal taxes upon distilled spirits was to revolutionize all these branches of industry, and in some instances to utterly destroy them. The manufacture of burning fluid as an illuminating agent entirely ceased; the necessity of its employment being at the same time most fortunately supplanted by the discovery of vast natural supplies of petroleum, and by the use of its derivatives. And as illustrative of the compensations which invariably attend the losses immediately contingent upon industrial progress, through disuse of old methods and machinery, it may be stated that although the business of the manufacture of burning fluid ceased, the business of collecting, preparing, and exporting petroleum rapidly became one of the most important in the country; while the demand at home and abroad for glass lamps and their appurtenances, adapted to the use of the distillates of petroleum, was alone sufficient to employ the entire manufacturing capacity of the glassworks of the United States for a period of two years.

Druggists and pharmaceutists in the United States estimated the reduction in the use of alcohol in their general business, consequent upon its increased cost from taxation, at from one

third to one half. Manufacturers of patent medicines and cosmetics abandoned their old styles of preparation and adopted new. Varnish makers reported to the revenue commission a reduction in the use of spirits in their business to the extent of 80 per cent; while a manufacturer of horse medicines, using formerly 50,000 proof gallons per annum, testified that his business was in the main destroyed. The same result also happened to a firm engaged in the manufacture of a substitute for whalebone, which previous to the tax on spirits was coming into extensive use; and as further showing how curiously other and apparently remote industries were affected by this tax, a large business of exporting cider to the Pacific, which for transportation through the tropics required to be fortified with alcohol, was seriously curtailed; while the increased price of vinegar, before manufactured largely from whisky, so far affected the cost of the manufacture of pickles and white lead as greatly to diminish domestic consumption and almost entirely prevent exports.

The first tax imposed on distilled spirits, of domestic production, was, as already stated, 20 cents per proof gallon. This tax yielded for the year ending June 30, 1863, a revenue of $3,229,911, indicating a production of 16,149,955 proof gallons. The tax of 20 cents continued in force until March, 1864, when the rate was advanced to 60 cents per gallon. The revenue derived from distilled spirits for the fiscal year ending June 30, 1864, under the two rates as above indicated, was $28,431,000. On the 10th of July, 1864, the tax was further advanced to $1.50 per proof gallon, and on the 1st of January succeeding to $2. The revenue derived from this source, for the fiscal year ending June 30, 1865, from the two rates, was $15,007,000; and for the succeeding fiscal years 1866 and 1867, under the uniform tax of $2, was respectively $29,481,000 and $29,164,000.

With the advent of high taxes upon this article, however, the initiation and practice of frauds upon the revenue commenced upon a most gigantic scale, and soon became so successful and so reduced to a system that in 1868 it seemed as if the whole country and the government itself were becoming corrupted and demoralized.

In the outset, while the war and its varying fortunes were engrossing the attention of the government and the people, the

efforts made to repress and punish frauds in this particular were absolutely of no account whatever; and, indeed, it may be alleged with truth that the whole spirit and working of the statute was in the direction of the encouragement and promotion of fraud — Congress in the first instance, under the influence of speculators, having advanced the rate of taxation on two occasions, with ample premonition, and without making the advance applicable to stocks on hand manufactured in anticipation of the legislation in question; and secondly, by so devising the law and providing for its execution as to make the detection and proof of fraud virtually impossible. Under this state of things there were repeated instances where distillers manufactured, conveyed to market, and fraudulently sold spirits in quantities varying from 20,000 to 80,000 gallons and upward, without a suspicion on the part of the local officers that the business was not in all respects conducted legally and honestly. It was also sworn to before the revenue commission in 1865–66 that the determination of the strength of the distilled spirits preparatory to assessment was often made by mere physical inspection or taste, and that the use of instruments (for which no uniform standard was provided) was discarded as something entirely unnecessary. It was also not infrequently the case that the barrels were inspected and branded some days in advance of their being filled, and the future regulation, the filling and removal, left entirely with the manufacturer. Distillers and their workmen were sometimes constituted inspectors of their own products, and in one instance an assessor was known to have been appointed who did not possess sufficient intelligence to understand or correctly use either a gauging rod or a hydrometer. Thus it was at the commencement; but subsequently, and after the close of the war, when the administration of the laws became more intelligent and vigorous, and some degree of concealment to the projectors of fraud became necessary, the expedients successfully adopted for the evasion of the tax were in the highest degree characteristic of the ingenuity of the people.

One of the most fertile of these expedients was made available through a provision of law which allowed spirits to be made and stored in bond, or exported in bond without prepayment of the taxes. Thus, for example, spirits deposited in bond were,

through the connivance and corruption of poorly paid officials, secretly withdrawn from bond, the barrels filled with water, or some cheap compound, and subsequently exported. On receipt of the landing certificate, obtained through a consul of an inferior grade in some remote country, the bonds given by the manufacturer for the payment of the taxes were canceled, and the profits divided among all concerned; while the barrels and contents, being once placed beyond the jurisdiction of the United States, were left either in a foreign bonded warehouse, or on foreign wharves, to take care of themselves. And thus it was that from Turkish ports in the Levant, and from places in Southern Asia, Africa, and Central America there came, in due time and in succession, not a few official inquiries in respect to the disposition of American property for which there was no recognized owner.

In one instance a considerable quantity of what purported to be spirits left a bonded warehouse for transportation in bond by a long, slow voyage down the Mississippi to New Orleans. On arrival at the port of destination the entire contents of the barrels was found to have escaped, through shrinkage and imperfect construction of the packages; and proof being submitted of the loss, the bonds given for delivery were canceled. It is needless to say, that what left the warehouse was not the spirits for which the bonds were originally given, but a substitute of water flavored with spirit, and that the imperfect material and construction of the barrels was designed to effect the very object which was accomplished, namely, the accounting for the destruction of what was known to have been the product of the distillery.

In short, such a tax, of about 800 per cent on the manufacturing cost of the article in question, the enormous profits consequent upon the evasion of the law, and the abundant opportunity which the law itself, and the vast territorial area of the country offered for evasion, constituted a temptation which it seemed impossible for either manufacturers, dealers, or officials to resist; and the longer the tax remained at a high figure, the less became the revenue, and the greater the corruption.

During the year 1867 the revenue directly collected from dis-

tilled spirits, as already stated, was about *twenty-nine millions of dollars*, but during the succeeding year, 1868, with no diminution, but rather an increase of the quantity manufactured and consumed, the total revenue from the same source was but little in excess of *fourteen millions;* proof spirits, at the same time being openly sold in the market, and even quoted in price currents, at from *five* to *fifteen* cents less per gallon than the rate of tax and the average cost of manufacture. We have also in these figures the materials for approximately estimating the measure and strength of the temptation to evade the law, and the amount of profit that accrued in a single year from the results of such evasion; for, as the consumption of distilled spirits for all purposes in the country during the year 1868 was probably not less than *sixty millions of gallons*, and as out of this the government collected a tax upon only about *seven millions* of gallons, the sale of the difference, at the current market rates, $1.90, less the average cost of production, *thirty* cents, must have returned to the credit of corruption, a sum approximating *eighty millions of dollars.*

But notwithstanding the fact that the current price at which distilled spirits were sold in the markets was less than the amount of tax, was everywhere recognized, and commented on by the press; and notwithstanding that the existence and extent of the frauds in the manufacture and sale of the spirits was for three years officially reported upon in detail by officers of the treasury, it was with great difficulty that Congress could be induced to take any action, looking to remedies by the enactment of more perfect laws, providing for more efficient administration of the law, or for diminishing the temptation to fraud by reducing the tax; and it was not until the revenue from this source bade fair to disappear altogether, and the popular manifestation of discontent became very apparent, that anything really was accomplished; a report from the committee of ways and means to the house of representatives in favor of a new law and a reduction of the tax having been actually delayed a whole year by the appeal of a leading member from the state of New York for postponement, on the ground that it would be derogatory to the honor of a great nation, after having triumphed in the most gigantic of civil wars, to confess, by a reduction of the rates, its

inability to control the production and sale of whiskey. How expensive this speech and its resulting delay proved to the treasury is shown by the circumstance, that when the tax was reduced the next year from $2 to 60 cents per gallon, and the law in other respects modified, so as to prevent transportation in bond — holding every distillery liable to account, according to capacity, for each day's product, and forfeiting real estate as well as personal property connected with the performance of illegal acts — the revenue from all taxes, direct and indirect (licenses, etc.), in the manufacture and sale of domestic spirits, increased the very first year to the extent of $27,000,000; or, from $18,-000,000 in 1868 to $45,000,000 in 1869, and $55,000,000 in the succeeding year, 1870.

68. Internal Taxation from 1870 to 1894. — Most of the duties upon commodities were repealed after the war, but a number of internal taxes were retained. The act of July 14, 1870, left in operation the duties upon spirits, fermented liquors, and tobacco; as well as stamp duties and some other taxes. The subsequent history of the internal revenue system is described by Dr. Frederic C. Howe, as follows:[1]

Previous to 1860, as we have seen, the excise had been viewed as a sort of fiscal reserve, only to be brought into action in case of urgent necessity; but at the termination of the Civil War, in view of the burden of indebtedness which it had entailed, it became apparent that the earlier resources were no longer adequate to satisfy the larger fiscal needs of the country. The war had, moreover, induced a more generous view of the Constitution, and the conservative hostility which had prevented the utilization of federal powers during the long tenure of the Democratic party no longer existed; while the subsequent inclination of the government to engage in all sorts of expenditure for various internal purposes rendered the utilization of inland sources as a portion of the permanent fiscal service a necessity. The reduction in expenditure between the years 1866 and 1870 rendered it possible

[1] Taxation in the United States, 215 *et seq.* (New York, T. Y. Crowell, 1896.) Reprinted with the consent of the author and publisher.

to dispense with nearly all the extraordinary war taxes, and to concentrate the system upon the broad and elastic basis of consumption. The income tax was retained until 1872, as were the bank taxes, and several unimportant duties on manufactured products. . . .

The suitableness of distilled and malt liquors and tobacco for taxation is recognized by nearly every civilized country, and it is the uniform practice of European governments to derive from them the largest possible revenue consistent with efficiency of administration. Of well-nigh universal consumption as they are, socially harmful in their effects, and non-essential to the comfort and well-being of a people, the payment of the taxes upon whiskey, beer, and tobacco may be viewed as a sum abstracted from the surplus fund of individual income. Furthermore, such taxes are but little obstructive of industrial freedom, and there is no evidence that even the highest rate imposed has ever proven productive of any very general discontent. From the mass of the people the cry for free whiskey and free tobacco meets no answering response; and in the past such agitation has been largely of a political character, for the purpose of distracting attention from an increase in the tariff rates, or an attempt to reduce a possible surplus in the treasury.

Since 1868 the history of the taxation of these subjects has been quite uneventful. The reduction of the rate on distilled spirits to 50 cents a gallon was accompanied with results most phenomenal. It is possibly too much to ascribe the subsequent increase in the revenues and improvement in their collection wholly to the reduction of the rates; for changes in the method of administration were also introduced, which greatly simplified collections, and rendered evasion by the ordinary methods well-nigh impossible. Since this time all taxes, specific, *ad valorem*, and license, have been collected by means of stamps, affixed to the packages containing the commodity or displayed in the place of business. The specific tax of 50 cents on whiskey, with the subsidiary capacity tax, remained in force from July, 1868, to August, 1872, during which period the tax was assessed upon an average production of 67,000,000 gallons, which yielded an average annual revenue of $34,000,000, indicating an average annual per capita consumption of 1.65 gallons.

By the same Act the rates upon manufactured tobacco and cigars were placed as follows:

Snuff	$0.32 per pound
Chewing and other tobacco prepared by hand . .	0.32 "
Smoking tobacco	0.16 "
Cigars	5.00 per 1000
Cigarettes	1.50 "

Alterations were also made in the method of assessment. Instead of the tax being collected after removal from the place of manufacture and sale, the duty from this time on was prepaid by means of soluble stamps,[1] placed upon the package at the place of manufacture. Goods were required to be placed in certain forms of packages, which were to indicate the manufacturers' name, place of manufacture, trade-mark, contents, and weight of package, etc. Itemized returns were also required from the producer in regard to his business. Failure to comply with these requirements rendered the producer liable to heavy penalties, as did any attempt to place untaxed goods on the market by a dealer. By the same Act existing taxes on mineral or illuminating oils and refined petroleum were repealed.

The revenues from tobacco immediately responded to the change. In 1868 the receipts were $18,729,000. In 1869 they rose to $23,430,707, a gain of four and three quarter millions. Again, in 1870, they increased to $31,350,707, and in 1871 to $33,578,907. Fraudulent evasion of the tax was greatly diminished. Some little loss did occur through the refilling and re-use of stamped packages, and the improper classifications of manufactured tobacco. It was easily possible for producers to take advantage of the difference of rates on chewing and smoking tobacco to place the former on the market at rates applicable only to the latter; and it was difficult to impute or prove fraud, or to correct the evil, save by a uniform rate, which change was later adopted.

But, despite the gratifying showing of the revenues, agitation was soon renewed for change. The profits previously secured by speculators and producers from legislative changes were too sweet to be willingly relinquished; and Congress was not deaf

[1] The stamps were printed in fugitive ink, which disappeared when washed for the purpose of re-use.

to the proposals for an increase of duties, by which gains were legislated into the pockets of speculators by increasing the rate without rendering it applicable to stock in bond. At the same time temperance agitators, who viewed a high rate on whiskey and tobacco as advisable on sumptuary grounds, advocated an increase in the duties, thinking it would serve as a deterrent to their use. In 1872, in response to this pressure, the rate upon whiskey was changed from the mixed one then prevailing, the barrel and capacity tax being repealed, while the specific rate was increased by 20 cents, or to 70 cents per gallon. The change was largely an administrative one, as the several duties then prevailing had aggregated between 65 and 70 cents per gallon. By the same measure all manufactured tobacco, whatever its value or use, was rendered dutiable at a uniform rate, the duty up to 1875 being 20 cents per pound.[1] While this was equivalent to a reduction of 6 cents per pound or of $22\frac{1}{3}$ per cent on the average rate for the two preceding years, the diminution in receipts from tobacco for the year 1873 was but little over one million dollars, while the increase in tax-paid production was over nineteen and one half million pounds, a result traceable in large part to the fact that unmanufactured tobacco under the new law was taxed at substantially the same rate as the manufactured article, whereas it had formerly been practically exempt.

These changes were uniformly in the line of improvement; for while it is to be acknowledged that there is some injustice in the taxation of any article like tobacco, whose value varies so widely, at a uniform rate, experience has shown that assessments are likely to be so arbitrary that a specific rate is preferable to an *ad valorem* one, for the latter offers great opportunities for fraudulent practice, false swearing, and complications in valuation.

Again, in 1875, the rate on spirits was advanced to 90 cents per gallon, where it remained unaltered until 1894. In the taxation of the latter article the experience of these years was marked by phenomena similar to those of the war, although less monstrous, and brought home to officials high in the government service. It is not true, however, as is frequently asserted,

[1] When it was again increased to 24 cents per pound.

that the frauds disclosed in 1875 were due to the increase in the rates; for, although discovered immediately after the passage of the Act of that year, they were traceable to complicity and conspiracy of officials, and had been in existence for many years previous to the change. That the increase of the rate to 90 cents was a source of gain to speculators there is no doubt, for the new duty was not made operative on stock in bond. During the three months previous to the date when the increased rate went into operation, there was made and stored sufficient spirits to cause a loss to the revenues of $1,400,000. This loss was but temporary, however; and from this time on down to the present day the revenues from this source have steadily increased in amount, and there is no reason to suppose that the tax was not as universally collected as under the earlier and lower rate.

With the general revival of trade which set in during the years immediately preceding 1880, the receipts from the several sources of internal revenue manifest a marked improvement. Beginning with 1878, they increase from $110,000,000 in that year to $124,000,000 in 1880, to $135,000,000 in 1881, and to $146,500,000 for the fiscal year 1882. At this time there remained, as a heritage of the war, taxes upon the following subjects, which produced for the fiscal year 1882 the following sums:

Friction matches	$3,272,258.00
Patent medicines, perfumery, etc.	1,978,395.56
Bank checks	2,318,455.14
Bank deposits	4,007,701.98
Savings-bank deposits	88,400.47
Bank capital	1,138,340.87
Savings-bank capital	14,729.38
	$12,818,281.40

At the same time taxes were collected by the treasurer of the United States from national banks as follows:

On national-bank deposits	$5,521,927.47
On national-bank capital	437,774.90
Collections from national banks	$5,959,702.37

making a total collection of $18,777,983.77.

As early as 1880 the commissioner of internal revenue had advised the repeal of all these taxes, and reiterated his suggestion

two years later, when he further advocated an abatement of 40 per cent in the special license charges then existing upon rectifiers, wholesale and retail liquor dealers, and tobacconists, from which an additional reduction in the revenues of $3,000,000 was expected.

The Act of March, 1879, had reduced the rate on manufactured tobacco by one third, or from 24 to 16 cents per pound; and a corresponding reduction on the rate on cigars would cause a further diminution in the revenue of $6,746,000, which the commissioner also recommended.

These suggestions were substantially followed in the abolition of all adhesive stamps imposed on matches, proprietary medicines, perfumes, and bank checks, the abatement taking effect July 1, 1883. The duties on bank deposits and capital ceased at the beginning of the same calendar year; while the rates on tobacco in all its forms, as well as the special license taxes, were reduced 50 per cent. The loss to the revenue from these combined abatements was variously estimated at from forty to forty-five millions, including the $6,000,000 collected from national banks by the treasurer. The loss fell much short of this estimate, however, the total decrease for 1884 being less than $23,000,000, a considerable gain being manifest in spirits and other sources. The chief loss lay in tobacco, from which the receipts fell from $47,391,000 in 1882, and $42,104,000 in 1883, to $26,062,000 in 1884. Inasmuch as the collections of 1882 were made under the old rate entirely, and those of 1884 wholly under the new one, it shows a falling off of $21,229,000, or nearly 45 per cent. When it is borne in mind that population was increasing at the rate of one and a quarter millions per year, it would seem to indicate that the consumption of tobacco was but little affected by the tax rate; for the increase in annual consumption after the reduced rate, as indicated by removal from bond, was but three and one half million pounds, the total withdrawals being less than the average quantity withdrawn for several preceding years at double the rates. At the same time a perceptible increase in the number of firms engaged in tobacco manufacture was remarked, a fact which seems to indicate the tendency of a high tax rate to concentrate the business into a few hands.

In 1890 another reduction of 25 per cent was made in the rates upon snuff, chewing and smoking tobacco, while all special license taxes upon the sale of tobacco were repealed.

The total receipts from tobacco in all its forms for 1893 were about $32,000,000, a sum which would have approximated $60,000,000 had the taxes existing in 1882 been allowed to remain unchanged. For the same year, the per capita revenue collected in the United States from this subject was but 48 cents, as against 90 cents in 1882, and as opposed to $1.71 in France, and $1.50 in Great Britain. Manifestly the revenues from this source are susceptible of increase. In recent years the growth in the consumption of tobacco has been phenomenal. In 1892 the per capita consumption of smoking and chewing tobacco was four pounds, while the number of cigars and cheroots returned for taxation was 4,548,799,487. As compared with other countries, the consumption of tobacco in America is about two and a half times as great as in England and France, slightly in excess of that in Holland and Belgium, and somewhat less than that of Germany.

The tax upon malt liquors has remained practically unchanged since the organization of the system in 1862, namely, at $1 per barrel of thirty one gallons.

In 1894, in order to obtain additional revenue, certain changes were made in the internal duties, as described by Dr. Howe:[1]

In addition to the duty upon incomes, the measure of Aug. 28, 1894, provided for a tax of 2 cents per pack upon playing cards sold within the United States subsequent to Aug. 1, 1894, as well as an increase of 22½ per cent in the rate upon distilled spirits, or from 90 cents to $1.10 per gallon, which increase was to be levied and collected upon all spirits in bond at the time of the passage of the Act or thereafter manufactured. This provision differed from previous legislation, in that the new rate was payable upon all spirits in bond rather than upon future production only. But, despite this provision, the gains which accrued to speculators were enormous, for it was evident as

[1] Taxation in the United States, 252–254.

early as June that the tax would be increased. As a consequence production was very active during this period, and speculators and distillers withdrew spirits in great quantities in order to anticipate the increase of the rate. During the months of July and August, 1894, 26,500,000 gallons more of spirits were withdrawn from the bonded warehouses than during the same months of 1893; while the total withdrawals during the two months previous to Sept. 1, 1894, were 36,554,088. Upon these withdrawals the old rate of 90 cents per gallon was paid, with the idea of holding the product until the new duty went into effect, when the stock would be disposed of upon the basis of the new rate. Assuming that the advantage which accrued upon withdrawals during the months previous to July offset any overestimate, the gains to distillers and speculators could not have been less than $7,000,000, all of which should have been saved to the treasury.

The measure further provided for an extension of the bonded period from three to eight years. In the past it has been the custom to collect the tax on tobacco, as well as the customs duties, when the commodity entered the market for consumption; but the principle has never been applied to spirits. The distiller has not only been required to pay the highest rate of tax imposed upon any product under the laws, but has been compelled to pay the same within a specified time, no matter what the demand for spirits or the condition of the market. This provision was frequently a cause of great hardship; and while an unlimited bonded period is not granted under the present law, as is permitted in tobacco and malt liquors, it has been extended to eight years, a provision which affords great relief to producers. How burdensome the former law was is shown by the large number of failures which occurred among distillers and holders of stock during the early days of the recent commercial depression.

From this increase of the rate to $1.10 a gallon, an annual gain of twenty millions of dollars is anticipated to the revenues.

69. **The War Taxes of 1898.** — In order to defray part of the expenses of the Spanish War, new internal taxes were established in 1898 and some of the existing duties were increased. Sub-

sequently all of these duties were repealed. The following account of the war taxes has been given by Professor C. C. Plehn:[1]

The United States government has never resorted to internal taxes except to pay the expenses of war, and with the single exception of the Mexican War, we have waged no war without the use of internal taxes. The first system of "internal revenue taxes," as we have learned to call them, was arranged by Hamilton, 1791, in the face of the most bitter opposition. An excise was declared to be "the horror of all free states" and "hostile to the liberties of the people." On account of the general hostility to that form of taxation — a hostility which led to armed resistance in the "Whiskey Rebellion" — the law was but feebly enforced. It was dubbed by Jefferson an "infernal system," and finally came to an end in 1802. To meet the expenses of the War of 1812 Congress again, reluctantly, resorted to internal taxation, but the taxes then introduced were never satisfactory and were hastily abandoned in 1817. From that time to the outbreak of the Civil War no internal taxes were levied for the support of the federal government.

The entire absence of any internal taxes and of any elastic element in the tax system at the outbreak of the Civil War added greatly to the difficulties involved in raising the revenues needed. Beginning in 1862, a vast and complex system of internal taxation was built up. Of this comprehensive system an acute French observer said: "The citizen of the Union pays a tax every hour of the day, either directly or indirectly, for every act of life; on his personal and real property; on his receipts and in his expenses; on his business and on his pleasures."[2]

The heavy expenses of the war debt necessitated the retention of many of these taxes even after the close of the war. As the years passed by, however, the most burdensome ones were removed. Still a sufficient number of important internal revenue taxes were permanently retained to yield about $150,000,000 a

[1] The Finances of the United States in the Spanish War, 434 *et seq.* Reprinted, with consent of author, from *The University Chronicle* of the University of California. Vol. I (1898).

[2] E. Duvergier de Hauranne, *Revue des deux mondes*, Aug. 15, 1865.

year. The continuance of these taxes in time of peace proved of great advantage when war broke out. That advantage was that they provided the administrative organization necessary for the collection of increased revenues. New taxes to be administered by the same machinery could be easily imposed and made remunerative within a very short time. Indeed there is almost no precedent in financial history for the immediate returns these new taxes yielded. The income from them during the very first month was over $12,000,000.

For the reasons explained in the last lecture, it was decided to raise the larger part of the revenue needed for the war by enlarging the existing system of internal taxes. The taxes of this kind in use were of three principal classes: (1) the group on spirits, yielding, in 1897, $82,008,543; (2) the group on tobacco, yielding $30,710,297; (3) the group on fermented liquors, yielding $32,472,162. The war revenue bill doubled the rates in two of these groups and rehabilitated a large number of the taxes used during the Civil War. The principles which guided the selection of the different taxes were stated by Mr. Dingley when explaining the bill to the house as follows:

"These taxes have been selected, first, because we have the machinery for the collection of them now, and they can be collected with but slight additions to the force and with but slight increase of expense. We have selected them also because they were a source of revenue successfully seized upon during the Civil War, and because they are taxes either upon articles of voluntary consumption or upon objects where the tax will be paid by those who are ordinarily able to pay them; and we have refrained from putting a tax in a direction where it would be purely upon consumption, unless the consumption was of an article of voluntary consumption, so that the consumer might regulate his own tax, following what is the accepted rule of taxation in all countries, with a view of imposing the least burden and disturbing the business of the country as little as possible."

Briefly summarized the aim of the bill was to obtain the money needed as quickly as possible. The question of the equal distribution of the burden among the people was not raised. The revenue bill was strictly an emergency measure. Although the senators showed a tendency to spin fine theories in regard to

the operation of certain taxes, yet the equality of the system as a whole was not considered. Senator Allison said of it:

"In the first place, this bill is here only because the government of the United States is involved in a war with a foreign country. If there were no war, there would be no necessity for this bill; and therefore it may be truly called, what it is denominated, a war measure."

It is not perhaps surprising, then, that the bill which was framed in this spirit contains a heterogeneous collection of taxes. It does not cull the fruit systematically from the orchard of industry, but plucks only a part of that which is most easily reached. The bill does not establish a system of taxation, but a group of taxes which absolutely defies classification.

We may study the war revenue bill under the following divisions: (1) Taxes already in use, the rates of which have been raised. (2) New excise taxes. (3) New business and corporation taxes. (4) Transaction taxes and business taxes in the form of stamp taxes on business documents. (5) Miscellaneous taxes.

Of the three groups of internal taxes in use at the time the internal revenue bill was presented, one, namely, that consisting of taxes on spirits, was left untouched. The rates imposed on the other two were doubled with the exception that the special taxes on dealers in beer and on brewers were left unchanged.[1]

The tax imposed on dealers in tobacco prior to 1890 was restored. The restoration of the tax on dealers in tobacco was regarded partly as a measure to enable the officers better to enforce the law in regard to the taxation of tobacco and cigars. No explanation was advanced during the discussion of the bill in Congress for not raising the rates on spirits. Had that class of goods been treated as beer and tobacco were treated, no other taxes would have been necessary. With the improved methods of administration now in use there could be no reason to fear the wholesale evasions which vitiated the attempt to levy high rates upon spirits during the Civil War. If, as was suggested in the last lecture, tea and coffee had both been made to contribute,

[1] Tax on beer, ale, and porter, increased from $1 to $2 a barrel, discount 7½ per cent. Tax on tobacco and snuff, 12 cents a pound; cigars and cigarettes, over three pounds per 1000, $3.60 per 1000; of less weight, cigars, $1, cigarettes, $1.50.

and, as now suggested, spirits had been treated as beer and tobacco were, we should have had ample revenues with the least possible additional cost. The amounts would have been:

Tea	$10,000,000
Coffee	70,000,000
Spirits	80,000,000
Beer	30,000,000
Tobacco	30,000,000
Total	$220,000,000

This is $70,000,000 more than the new taxes which were imposed yield, so that the additional rates need have been but two thirds of the increase suggested. Indeed, an increase of half the amount suggested in the taxes on tea, coffee, spirits, beer, and tobacco would have furnished over $100,000,000, or more than the amount which the House Committee on Ways and Means thought necessary to raise by taxation. It is needless to say that such taxation would have been very much more easily borne by the people than the multitude of new taxes imposed. Had that plan been followed, there would have been few of us who would know by actual experience that we were paying the expenses of a war.

New excise taxes to be collected by the use of stamps were imposed on patent and proprietary medicines and toilet articles. on chewing gum, and on wine.[1]

Little can be said in favor of these taxes; they strike a vast variety of different articles of consumption and their effect is anything but uniform. Consumption is a very poor basis for taxation. The rates are so moderate, however, that there is little temptation to shift the taxes and the articles taxed are in

[1] Medicines and toilet articles.

Retail Price of Packages	Stamps
1 to 5 cents	1/8 of 1 cent
5 to 10 cents	1/4 of 1 cent
10 to 15 cents	3/8 of 1 cent
15 to 25 cents	5/8 of 1 cent
For each additional 25 cents	5/8 of 1 cent

Chewing gum, 4 cents for each package of not more than $1 in retail price and 4 cents for each additional $1 in retail price, or fraction thereof.

Wine per bottle of one pint or less, 1 cent; per bottle of over one pint, 2 cents.

many instances monopoly products, the prices of which, it may be assumed, are already as high as they can be made without decreasing the sales. In some instances, therefore, these are not taxes on consumption but taxes on the profits of monopoly businesses. There has, indeed, been no general tendency to increase the prices of these articles. To be sure the imposition of the tax has checked the tendency to cut rates and to that extent may be said to have raised the prices of some articles widely regarded as necessities, but that effect will be only temporary. While, therefore, these new excise taxes have not added a very desirable element to our tax system, they are not seriously harmful.

The new business taxes are of two classes. The first are those laid on bankers, brokers, museums and concert halls, circuses and other public exhibitions, bowling alleys and billiard and pool rooms.[1] The second are those on refiners of petroleum and sugar and on pipe-line companies.

In the first of these classes the most serious difficulties that have arisen are clearly revealed in connection with the application of the law to foreign banks. The law makes no special provision for them and they do not come properly under the general provisions. Strictly speaking a branch of a foreign bank doing business in this country has no capital located here. Such banks would, therefore, pay but $50, the minimum tax which all bankers must pay. But as these houses often do a vast business such a tax would be obviously unfair. The law of 1864 which was partly copied in the new law was much more explicit. It provided a method for determining the capital of branch banks. The total capital of the bank was to be apportioned among the different branches according to the amount of the business done by each. This method was applied to foreign banks. That old law, however, laid a tax on deposits, dividends, and profits as well as upon capital, so that the burden fell with greater equality upon all the banks. While the inequality of this tax is best revealed by the difficulty

[1] Bankers, $50 a year and $2 for each $1000 over $25,000 of capital; brokers, $50; pawnbrokers and commercial brokers, $20; custom-house brokers, $10; theaters, etc., $100; circuses, $100 for each state in which they do business; bowling alleys, etc., $5 for each alley or table.

of applying the law to foreign banks, it also arises in every other case. The amount of capital used is never commensurate with the business done, nor with the ability of the bank to contribute. There are, for example, fifteen commercial banks in San Francisco. In one of these the capital is 19 per cent of the business being done, as measured by the total assets and liabilities; in another it is 79 per cent. Although the total assets and liabilities are only an approximate measure of the bank's ability to pay, yet this comparison shows that the new tax is many times as heavy on the second bank as on the first. Generally speaking, the smaller the bank, the heavier this tax is likely to be. The same inequality pervades the other special business taxes. A small theater or a small circus pays the same tax as a large one. Probably some of the smaller ones will be driven out of business. Possibly, however, this is not a result to be deplored. This whole group of taxes seems to have been snatched indiscriminately from the system of internal taxes developed during the Civil War. The old system was by no means a complete or a just one, and the scattered sections adopted in the new law form far less of a system.

The tax on refiners of petroleum or sugar and on pipe-line companies which was placed at a quarter of one per cent on the excess of gross receipts above $250,000 a year is the remnant of a tax on the gross receipts of nearly all corporations which was proposed by the majority of the Senate Committee on Finance. The minority of that committee, however, objected to such a sweeping tax, first, on the ground that it would burden many commodities several times over, and second, on the ground that many corporations, and especially the smaller ones, had to compete with unincorporated business houses and firms, and that the latter would be given an advantage. It was urged during the discussion that the tendency to form corporations was a public calamity, and should be checked by this form of taxation. A tax on the gross receipts of railroads, bridges, canals, express companies, ferries, lotteries, ships, barges, stages, steamboats, and telegraph and insurance companies had been used with great success during the Civil War. It was proposed to renew this tax and to extend it to all corporations in spite of the fact that many of them were heavily taxed by other parts of the law.

There were very large elements of injustice in the proposed tax, and the only argument advanced in favor of retaining the tax on the oil and sugar trust was that they were monopolies. The tax is not severe. It will not be above one and a quarter cents per hundred pounds of sugar nor above one and a half cents per hundred gallons of oil at the prevailing wholesale rates, so that there will be little temptation to shift the tax even if the companies would not lose more by reduced sales from an attempt to raise prices than they would gain by shifting the tax. There is little likelihood that the tax will affect retail prices.

A very large number of transaction taxes and of business taxes was levied in the form of stamp taxes on business documents and on the means of communication. These taxes are usually known as stamp taxes, but the name indicates merely the means of collection and shows nothing of the nature of the tax. In general these taxes are based upon recognition of the fact that when wealth is transferred from one person to another, its existence is manifested and a convenient moment occurs for the imposition of a tax. When such a transfer is accompanied by a document which is legal evidence of the title of the new owner, it is easy for the government to refuse legal recognition to such a document unless accompanied by the evidence that the tax has been paid. It is, therefore, practically impossible to evade such a tax. The most convenient way of collecting these taxes is by the sale of stamps which are to be attached to the documents as evidence of payment. There are two features of these taxes which commend them as emergency taxes. In the first place, even at a low rate they can be made to yield a considerable income, and the return is a quick one, as large the first month as at any time afterward. In the second place they are very inexpensive to administer: the taxpayer himself acts as tax collector and when he goes to the office to purchase the stamps, brings in the revenue. He cannot omit to pay his tax lest his document prove illegal. During the Civil War and for many years afterward stamp taxes of this sort were in use. Many of the provisions of the old law were transferred to the new law, and the changes and omissions are rarely for the better.

It would be tedious to enumerate all the transactions which

are taxed in this way, nor is it necessary, as I can comment on but few of them. The first thing that strikes one who carefully scans the long schedules of these taxes is that they are frightfully unequal. Only here and there are they graded according to the value of the thing taxed. Thus the tax on the issue of corporation stocks is five cents on each $100 of the par value, and on the transfer of the stock is two cents on each $100 of the par value. But the par value of a stock is a perfectly arbitrary thing, a mere name. It is usually $100, but the true value may be anywhere from one cent to $1000 or over, according to the success of the enterprise. So, too, with checks and drafts; whatever the value may be, the tax is always two cents. Indeed, in this particular case the form of the tax defeats its end as a revenue measure, for it has simply resulted in the writing of fewer and of larger checks, and more has been lost to the postal revenues through less frequent remittances than has been gained from the tax on checks.

All of that part of the law which deals with drafts and bills of exchange is so faultily drawn as to be practically unintelligible. The technical terms of banking are used in strange and unusual senses, and totally incongruous things, such, for example, as inland bills of exchange and certificates of deposit bearing interest are grouped together. These provisions should have been drawn by a practical banker. Had the new tax law not been supported by that patriotic sentiment which so largely aided its enforcement, this particular part of the law would have given rise to more lawsuits than revenue.

Included under the stamp taxes are certain taxes directed more or less vaguely at certain classes of corporations. These are the taxes on freight bills, express receipts, parlor and sleeping car tickets, telegrams and telephone messages, and passage tickets to foreign countries. The rates on the last are graded according to value, but on all the others are uniform at one cent each, except that no tax falls on telephone messages below fifteen cents. The tax on telephone messages is not collected by stamps. It is easy to see that this is a most unequal system. There has been much discussion as to whether it was the intention of the law that the stamp should be furnished by the companies or by their patrons. This is really a matter of little

moment. In some cases the tax is so slight as to be entirely immaterial. In such cases the companies have furnished the stamps themselves to save their patrons any annoyance, and have not changed their rates. In other cases the tax is so severe that if the companies furnish the stamps, they will be obliged to shift the tax by raising their rates, in order to live. If the tax were paid by the express companies, it would vary from 4 per cent of the gross receipts down to practically nothing. For doing a twenty-five-cent errand the express company would pay one cent, and no more for a shipment of $1,000,000 in gold. The express companies have asserted that if they have to pay the tax, it will take half of their profits. The tax is also very severe on telegrams. The average telegram, it has been estimated, costs 24.3 cents and the average profit is six cents, of which the tax is $16\frac{2}{3}$ per cent. Whatever may have been the intention of the law as to who should furnish the stamp in such cases, it is clear that the tax will be shifted to the patron of the company. If it is finally decided that the company must furnish the stamp, then the rates will have to be raised, and the patron will have to pay the tax just as much as if he furnished the stamp himself. Taxes which appropriate for the use of the government from 10 per cent to 50 per cent of the net profits of any business are bound to be shifted. Still the companies cannot escape considerable loss even by shifting the tax. If they raise the rates in order to cover the tax, their business will fall off, while the expense of doing it will not decrease in like measure. If they could raise their rates without loss of business, there is every reason to suppose they would do so, tax or no tax. On the other hand the public is the loser as well as the companies. In the first place it is obliged to pay the tax, or at least a part of it, and in the second place it is obliged by the increased cost to curtail its use of the facilities which the companies furnish. When taxation approaches confiscation, it strikes directly at the welfare of the whole people.

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Among the miscellaneous taxes there was also inserted one upon mixed or adulterated flour. The imposition of this tax is not mainly for revenue. It is for the purpose of regulation and to protect the public from unknowingly using inferior flour. On

oleomargarine there is a similar tax that has been in use for some time. It was asserted in Congress that as much as 75 or 80 per cent of all flour sold is adulterated by the use of ground clay, ground rock, "mineraline," or corn flour bleached by sulphuric acid. It is not claimed that all of the articles used for the adulteration of flour are injurious to health, but some of them are, and none of them has the same value for nutrition as wheat flour. The law requires these flours to be properly labeled, and by imposing a stamp tax on them the government can enforce this regulation. Without such a tax the federal government would not be competent to invade this sphere of state activities. A number of penalties are imposed for failure to comply with all the regulations. From now on it will be dangerous for any person to sell mixed flour under the guise of pure flour.

The general system of taxation imposed by this law is not particularly burdensome as a whole. In some instances individual parts of the system run very close to confiscation, and the system is frightfully unequal. At the same time most of the unequal taxes can be wholly or partly shifted and the severity of the burden is thus lightened by diffusion. The inequality and injustice of the system which we have noted all through the law is, perhaps, a necessary feature of any system that is adopted in an emergency, when the time is lacking for the full discussion of a logical and just system. It emphasizes the necessity, so often referred to, of arranging in time of peace a just and equitable system which can be readily expanded in time of war. During a war no nation can afford the luxury of tax reform for reform's sake. That is an enjoyment which belongs to times of peace.[1]

[1] Statistics showing the productivity of the various internal taxes at different times are given in the Appendix. — ED.

CHAPTER XX

THE EARLY DEVELOPMENT OF PUBLIC BORROWING

70. The Views of David Hume. — In 1752, at a time when the rapid growth of public debts was alarming many persons, David Hume published his celebrated Essay on Public Credit.[1] In this essay he draws the following unfavorable contrast between the practice of public borrowing and the earlier policy of accumulating state treasures in order to meet unusual emergencies:

It appears to have been the common practice of antiquity, to make provision, during peace, for the necessities of war, and to hoard up treasures beforehand as the instruments either of conquest or defence; without trusting to extraordinary impositions, much less to borrowing, in times of disorder and confusion.[2] Besides the immense sums above mentioned, which were amassed by Athens, and by the Ptolemies, and other successors of Alexander; we learn from Plato, that the frugal Lacedemonians had also collected a great treasure; and Arrian and Plutarch take notice of the riches which Alexander got possession of on the conquest of Susa and Ecbatana, and which were reserved, some of them, from the time of Cyrus. If I remember right, the scripture also mentions the treasure of Hezekiah and the Jewish princes; as profane history does that

[1] In his Political Discourses, (1752).

[2] The earliest writers on finance believed that a prince should thus accumulate treasure. Bodin, for instance, after treating of public revenues and expenditures, devoted the remainder of the chapter to "the reserve that should be accumulated for time of need." The German cameralists strongly advocated this policy. In England, also, state treasures were advocated by such a writer as Thomas Mun, who declared that "a Prince that will not oppress his people, and yet be able to maintain his Estate and his Right, that will not run himself into Poverty, Contempt, Hate, and Danger, must lay up treasure, and be thrifty." . . . England's Treasure by Foreign Trade, ch. 17. (Published 1664; written prior to 1641.) — Ed.

of Philip and Perseus, kings of Macedon. The ancient republics of Gaul had commonly large sums in reserve. Every one knows the treasure seized in Rome by Julius Cæsar, during the civil wars: and we find afterward, that the wiser emperors, Augustus, Tiberius, Vespasian, Severus, etc., always discovered the prudent foresight, of having great sums against any public exigency.

On the contrary, our modern expedient, which has become very general, is to mortgage the public revenues, and to trust that posterity will pay off the incumbrances contracted by their ancestors: And they, having before their eyes, so good an example of their wise fathers, have the same prudent reliance on *their* posterity; who, at last, from necessity more than choice, are obliged to place the same confidence in a new posterity. But not to waste time in declaiming against a practice which appears ruinous, beyond all controversy; it seems pretty apparent, that the ancient maxims are, in this respect, more prudent than the modern; even though the latter had been confined within some reasonable bounds, and had ever, in any instance, been attended with such frugality, in time of peace, as to discharge the debts incurred by an expensive war. For why should the case be so different between the public and an individual, as to make us establish different maxims of conduct for each? If the funds of the former be greater, if its resources be more numerous, they are not infinite; and as its frame should be calculated for a much longer duration than the date of a single life, or even of a family, it should embrace maxims, large, durable, and generous, agreeably to the supposed extent of its existence. To trust to chances and temporary expedients, is, indeed, what the necessity of human affairs frequently renders unavoidable; but whoever voluntarily depend upon such resources, have not necessity, but their own folly, to accuse for their misfortunes, when any such befall them.

If the abuses of treasures be dangerous, either by engaging the state in rash enterprises, or making it neglect military discipline, in confidence of its riches; the abuses of mortgaging are more certain and inevitable; poverty, impotence, and subjection to foreign powers.

According to modern policy war is attended with every de-

structive circumstance; loss of men, increase of taxes, decay of commerce, dissipation of money, devastation by sea and land. According to ancient maxims, the opening of the public treasure, as it produced an uncommon affluence of gold and silver, served as a temporary encouragement to industry, and atoned, in some degree, for the inevitable calamities of war.

It is very tempting to a minister to employ such an expedient, as enables him to make a great figure during his administration, without overburthening the people with taxes, or exciting any immediate clamors against himself. The practice, therefore, of contracting debt will almost infallibly be abused, in every government. It would scarcely be more imprudent to give a prodigal son a credit in every banker's shop in London, than to empower a statesman to draw bills, in this manner, upon posterity.

71. The Views of Adam Smith. — Twenty-four years later, Adam Smith discussed at greater length the development of public debts. After explaining that a disposition "to save and to hoard" prevailed in earlier times before the growth of extensive manufactures and commerce, he said:[1]

Among nations to whom commerce and manufactures are little known, the sovereign, it has been observed in the fourth book, is in a situation which naturally disposes him to the parsimony requisite for accumulation. In that situation the expense even of a sovereign cannot be directed by that vanity which delights in the gaudy finery of a court. The ignorance of the times affords but few of the trinkets in which that finery consists. Standing armies are not then necessary, so that the expense even of a sovereign, like that of any other great lord, can be employed in scarce anything but bounty to his tenants, and hospitality to his retainers. But bounty and hospitality very seldom lead to extravagance; though vanity almost always does. All the ancient sovereigns of Europe, accordingly, had treasures. Every Tartar chief in the present times is said to have one.

In a commercial country abounding with every sort of expen-

[1] Wealth of Nations, Bk. V, ch. 3.

sive luxury, the sovereign, in the same manner as almost all the great proprietors in his dominions, naturally spends a great part of his revenue in purchasing those luxuries. His own and the neighboring countries supply him abundantly with all the costly trinkets which compose the splendid but insignificant pageantry of a court. . . . How can it be supposed that he should be the only rich man in his dominions who is insensible to pleasures of this kind? If he does not, what he is very likely to do, spend upon those pleasures so great a part of his revenue as to debilitate very much the defensive power of the state, it cannot well be expected that he should not spend upon them all that part of it which is over and above what is necessary for supporting that defensive power. His ordinary expense becomes equal to his ordinary revenue, and it is well if it does not frequently exceed it. The amassing of treasure can no longer be expected, and when extraordinary exigencies require extraordinary expenses, he must necessarily call upon his subjects for an extraordinary aid. The present and the late king of Prussia are the only great princes of Europe who, since the death of Henry IV of France, in 1610, are supposed to have amassed any considerable treasure.[1] The parsimony which leads to accumulation has become almost as rare in republican as in monarchical governments. The Italian republics, the United Provinces of the Netherlands, are all in debt. The canton of Berne is the single republic in Europe which has amassed any considerable treasure. The other Swiss republics have not. The taste for some sort of pageantry, for splendid buildings, at least, and other public ornaments, frequently prevails as much in the apparently sober senate house of a little republic as in the dissipated court of the greatest king.

The want of parsimony in time of peace, imposes the necessity of contracting debt in time of war. When war comes, there is no money in the treasury but what is necessary for carrying

[1] Frederick William I, by persistent economy, had accumulated at the end of his reign a treasure of 8,700,000 thalers, besides plate worth 1,500,000 thalers. This treasure defrayed the greater part of the extraordinary expense of Frederick the Great's Silesian wars. In time of peace, Frederick, like his father, amassed a considerable treasure, which at his death amounted to 55,000,000 thalers. — ED.

on the ordinary expense of the peace establishment. In war an establishment of three or four times that expense becomes necessary for the defense of the state, and consequently a revenue three or four times greater than the peace revenue. Supposing that the sovereign should have, what he scarce ever has, the immediate means of augmenting his revenue in proportion to the augmentation of his expense, yet still the produce of the taxes, from which this increase of revenue must be drawn, will not begin to come into the treasury till perhaps ten or twelve months after they are imposed. But the moment in which war begins, or rather the moment in which it appears likely to begin, the army must be augmented, the fleet must be fitted out, the garrisoned towns must be put into a posture of defense; that army, that fleet, those garrisoned towns, must be furnished with arms, ammunition, and provisions. An immediate and great expense must be incurred in that moment of immediate danger, which will not wait for the gradual and slow returns of the new taxes. In this exigency government can have no other resource but in borrowing.

The same commercial state of society which, by the operation of moral causes, brings government in this manner into the necessity of borrowing, produces in the subjects both an ability and an inclination to lend. If it commonly brings along with it the necessity of borrowing, it likewise brings with it the facility of doing so.

A country abounding with merchants and manufacturers, necessarily abounds with a set of people through whose hands not only their own capitals, but the capitals of all those who either lend them money, or trust them with goods, pass as frequently, or more frequently, than the revenue of a private man, who, without trade or business, lives upon his income, passes through his hands. The revenue of such a man can regularly pass through his hands only once in a year. But the whole amount of the capital and credit of a merchant, who deals in a trade of which the returns are very quick, may sometimes pass through his hands two, three, or four times in a year. A country abounding with merchants and manufacturers, therefore, necessarily abounds with a set of people who have it at all times in their power to advance, if they choose to do so, a very large

sum of money to government. Hence the ability in the subjects of a commercial state to lend.

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government. The same confidence which disposes great merchants and manufacturers, upon ordinary occasions, to trust their property to the protection of a particular government, disposes them, upon extraordinary occasions, to trust that government[1] with the use of their property. By lending money to government, they do not even for a moment diminish their ability to carry on their trade and manufactures. On the contrary, they commonly augment it. The necessities of the state render government upon most occasions willing to borrow upon terms extremely advantageous to the lender. The security which it grants to the original creditor, is made transferable to any other creditor, and, from the universal confidence in the justice of the state, generally sells in the market for more than was originally paid for it. The merchant or moneyed man makes money by lending money to government, and instead of diminishing, increases his trading capital. He generally considers it as a favor, therefore, when the administration admits him to a share in the first subscription for a new loan. Hence the inclination or willingness in the subjects of a commercial state to lend.

The government of such a state is very apt to repose itself upon this ability and willingness of its subjects to lend it their money on extraordinary occasions. It foresees the facility of borrowing, and therefore dispenses itself from the duty of saving.

In a rude state of society there are no great mercantile or

[1] To this it may be added that, with the development of democratic government, the capitalists lend to a government which is under the control — to a very large extent, at least — of the propertied classes. *Cf.* H. C. Adams, Public Debts, 9 (New York, 1887). — ED.

manufacturing capitals. The individuals who hoard whatever money they can save, and who conceal their hoard, do so from a distrust of the justice of government, from a fear that if it was known they had a hoard, and where that hoard was to be found, they would quickly be plundered. In such a state of things few people would be able, and nobody would be willing, to lend their money to government on extraordinary exigencies. The sovereign feels that he must provide for such exigencies by saving, because he foresees the absolute impossibility of borrowing. This foresight increases still further his natural disposition to save.

The progress of the enormous debts which at present oppress, and will in the long run probably ruin,[1] all the great nations of Europe, has been pretty uniform. Nations, like private men, have generally begun to borrow upon what may be called personal credit, without assigning or mortgaging any particular fund for the payment of the debt; and when this resource has failed them, they have gone on to borrow upon assignments or mortgages of particular funds.

What is called the unfunded debt of Great Britain is contracted in the former of those two ways. It consists partly in a debt which bears, or is supposed to bear, no interest, and which resembles the debts that a private man contracts upon account; and partly in a debt which bears interest, and which resembles what a private man contracts upon his bill or promissory note. The debts which are due either for extraordinary services, or for services either not provided for, or not paid at the time when they are performed; part of the extraordinaries of the army, navy, and ordnance, the arrears of subsidies to foreign princes, those of seamen's wages, etc., usually constitute a debt of the first kind. Navy and exchequer bills, which are issued sometimes in payment of a part of such debts and sometimes for other purposes, constitute a debt of the second kind; exchequer bills bearing interest from the day on which they are issued, and

[1] Such pessimistic views were common in Smith's time. Hume, it will be remembered, had dismal forebodings; and even prophesied "the natural death of public credit," through national bankruptcy. And Montesquieu, after enumerating the evils attending public borrowing, said: "These are the disadvantages: I do not know of any advantages." *Esprit des lois*, Bk. XXII, ch. 17. — ED.

navy bills six months after they are issued. The bank of England, either by voluntarily discounting those bills at their current value, or by agreeing with government for certain considerations to circulate exchequer bills, that is, to receive them at par, paying the interest which happens to be due upon them, keeps up their value and facilitates their circulation, and thereby frequently enables government to contract a very large debt of this kind. . . .

When this resource is exhausted, and it becomes necessary, in order to raise money, to assign or mortgage some particular branch of the public revenue for the payment of the debt, government has upon different occasions done this in two different ways. Sometimes it has made this assignment or mortgage for a short period of time only, a year, or a few years, for example; and sometimes for perpetuity. In the one case, the fund was supposed sufficient to pay, within the limited time, both principal and interest of the money borrowed. In the other, it was supposed sufficient to pay the interest only, or a perpetual annuity equivalent to the interest, government being at liberty to redeem at any time this annuity, upon paying back the principal sum borrowed. When money was raised in the one way, it was said to be raised by anticipation; when in the other, by perpetual funding, or, more shortly, by funding.[1]

In Great Britain the annual land and malt taxes are regularly anticipated every year, by virtue of a borrowing clause constantly inserted into the acts which impose them. The bank of England generally advances at an interest, which since the revolution has varied from 8 to 3 per cent, the sums for which those taxes are granted, and receives payment as their produce gradually comes in. If there is a deficiency, which there always is, it is provided for in the supplies of the ensuing year. The only considerable branch of the public revenue which yet remains unmortgaged is thus regularly spent before it comes in.

[1] Funded debt, therefore, meant originally debt of which the payment of the interest (and sometimes of the principal) was secured by the pledge of certain taxes or other sources of revenue. In time, however, the meaning of the term has changed; and it now means usually debt which, by formal agreement, is to run for a considerable length of time or in perpetuity. See Palgrave, Dictionary of Political Economy, II, 169. — Ed.

Like an improvident spendthrift, whose pressing occasions will not allow him to wait for the regular payment of his revenue, the state is in the constant practice of borrowing of its own factors and agents, and of paying interest for the use of its own money.

In the reign of King William, and during a great part of that of Queen Anne, before we had become so familiar as we are now with the practice of perpetual funding, the greater part of the new taxes were imposed but for a short period of time (for four, five, six, or seven years only), and a great part of the grants of every year consisted in loans upon anticipations of the produce of those taxes. The produce being frequently insufficient for paying within the limited term the principal and interest of the money borrowed, deficiencies arose, to make good which it became necessary to prolong the term.

In 1697, by the 8th of William III, c. 20, the deficiencies of several taxes were charged upon what was then called the first general mortgage or fund, consisting of a prolongation to Aug. 1, 1706, of several different taxes, which would have expired within a shorter term, and of which the produce was accumulated into one general fund. The deficiencies charged upon this prolonged term amounted to £5,160,459, 14*s*. 9½*d*.

(Smith then proceeds to explain how this operation was repeated in 1701, 1707, 1708, 1709, 1710, 1711, 1715, and 1717; so that a number of taxes pledged originally for the payment of principal and interest of temporary loans were pledged perpetually for the payment of the interest of perpetual loans representing the principal of temporary loans which had been allowed to go unpaid. — Ed.)

In consequence of those different acts, the greater part of the taxes which before had been anticipated only for a short term of years, were rendered perpetual as a fund for paying, not the capital, but the interest only, of the money which had been borrowed upon them by different successive anticipations.

Had money never been raised but by anticipation, the course of a few years would have liberated the public revenue, without

any other attention of government besides that of not overloading the fund by charging it with more debt than it could pay within the limited term, and of not anticipating a second time before the expiration of the first anticipation. But the greater part of European governments have been incapable of those attentions. They have frequently overloaded the fund even upon the first anticipation; and when this happened not to be the case, they have generally taken care to overload it, by anticipating a second and a third time before the expiration of the first anticipation. The fund becoming in this manner altogether insufficient for paying both principal and interest of the money borrowed upon it, it became necessary to charge it with the interest only, or a perpetual annuity equal to the interest, and such unprovident anticipations necessarily gave birth to the more ruinous practice of perpetual funding. But though this practice necessarily puts off the liberation of the public revenue from a fixed period to one so indefinite that it is not very likely ever to arrive; yet as a greater sum can in all cases be raised by this new practice than by the old one of anticipations, the former, when men have once become familiar with it, has in the great exigencies of the state been universally preferred to the latter. To relieve the present exigency is always the object which principally interests those immediately concerned in the administration of public affairs. The future liberation of the public revenue they leave to the care of posterity.

During the reign of Queen Anne, the market rate of interest had fallen from 6 to 5 per cent, and in the twelfth year of her reign 5 per cent was declared to be the highest rate which could lawfully be taken for money borrowed upon private security. Soon after the greater part of the temporary taxes of Great Britain had been rendered perpetual, and distributed into the Aggregate, South Sea, and General Funds, the creditors of the public, like those of private persons, were induced to accept of 5 per cent for the interest of their money, which occasioned a saving of 1 per cent upon the capital of the greater part of the debts which had been thus funded for perpetuity, or of one sixth of the greater part of the annuities which were paid out of the three great funds above mentioned. This saving left a considerable surplus in the produce of the different taxes which had

been accumulated into those funds, over and above what was necessary for paying the annuities which were now charged upon them, and laid the foundation of what has since been called the Sinking Fund. In 1717, it amounted to £323,434, *7s. 7½d.* In 1727, the interest of the greater part of the public debts was still further reduced to 4 per cent; and in 1753 and 1757, to 3½ and 3 per cent; which reductions still further augmented the sinking fund.[1]

A sinking fund, though instituted for the payment of old, facilitates very much the contracting of new debts. It is a subsidiary fund always at hand to be mortgaged in aid of any other doubtful fund, upon which money is proposed to be raised in any exigency of the state. Whether the sinking fund of Great Britain has been more frequently applied to the one or to the other of those two purposes, will sufficiently appear by and by.

Besides those two methods of borrowing, by anticipations and by perpetual funding, there are two other methods, which hold a sort of middle place between them. These are, that of borrowing upon annuities for terms of years, and that of borrowing upon annuities for lives.[2]

During the reigns of King William and Queen Anne, large

[1] A sinking fund is a fund formed by the setting apart of annual surpluses, or moneys otherwise obtained, with a view to the ultimate application of the fund thus accumulated to the payment of public debts previously incurred. Sir Robert Walpole's sinking fund act of 1716, to which Smith refers, provided that the surplus taxes described by Smith, should "be appropriated, reserved, and employed to and for discharging the principal and interest of such national debts and incumbrances as were incurred before the 25th December, 1716, . . . and to or for none other use, interest, or purpose whatsoever." *Cf.* Palgrave, Dictionary of Political Economy, III, 405. — Ed.

[2] Annuities for terms of years — terminable annuities, as they are called — yield the holder interest and an annual installment of the principal of the loan, the payments being so computed as to return the entire principal with interest at the expiration of a certain term of years. Life annuities provide for payments that continue to the end of the annuitant's life. The "perpetual debt," described by Smith in the earlier paragraphs, consisted of perpetual annuities, in which the government agreed to pay in perpetuity the annual interest on the loan. Such an annuity, however, could be canceled by returning the principal, and was not perpetual in the sense that it could never be retired. In Europe annuities have been a favorite method of borrowing money. In the United States the common method has been the issue of bonds which call for the payment of stated interest and the return of the principal at a stipulated date. — Ed.

sums were frequently borrowed upon annuities for terms of years, which were sometimes longer and sometimes shorter. In 1693, an act was passed for borrowing one million upon an annuity of 14 per cent, or of £140,000 a year for 16 years. In 1691, an act was passed for borrowing a million upon annuities for lives, upon terms, which in the present times would appear very advantageous. But the subscription was not filled up. . . . In the reign of Queen Anne, money was upon different occasions borrowed both upon annuities for lives, and upon annuities for terms of 32, of 89, of 98, and of 99 years. In 1719, the proprietors of the annuities for 32 years were induced to accept in lieu of them South Sea stock to the amount of 11½ years' purchase of the annuities, together with an additional quantity of stock equal to the arrears which happened then to be due upon them. In 1720, the greater part of the other annuities for terms of years, both long and short, were subscribed into the same fund. . . .

During the two wars which began in 1739 and in 1755, little money was borrowed either upon annuities for terms of years, or upon those for lives. An annuity for 98 or 99 years, however, is worth nearly as much money as a perpetuity, and should, therefore, one might think, be a sum for borrowing nearly as much. But those who, in order to make family settlements, and to provide for remote futurity, buy into the public stocks, would not care to purchase into one of which the value was continually diminishing; and such people make a very considerable proportion both of the proprietors and purchasers of stock. An annuity for a long term of years, therefore, though its intrinsic value may be very nearly the same with that of a perpetual annuity, will not find nearly the same number of purchasers. The subscribers to a new loan, who mean generally to sell their subscription as soon as possible, prefer greatly a perpetual annuity redeemable by parliament, to an irredeemable annuity for a long term of years of only equal amount. The value of the former may be supposed always the same, or very nearly the same; and it makes, therefore, a more convenient transferable stock than the latter.

During the two last-mentioned wars, annuities, either for terms of years or for lives, were seldom granted but as pre-

miums to the subscribers to a new loan, over and above the redeemable annuity or interest upon the credit of which the loan was supposed to be made. They were granted, not as the proper fund upon which the money was borrowed, but as an additional encouragement to the lender.

Annuities for lives have occasionally been granted in two different ways; either upon separate lives, or upon lots of lives, which in French are called Tontines, from the name of their inventor.[1] When annuities are granted upon separate lives, the death of every individual annuitant disburthens the public revenue so far as it was affected by his annuity. When annuities are granted upon tontines, the liberation of the public revenue does not commence till the death of all the annuitants comprehended in one lot, which may sometimes consist of twenty or thirty persons, of whom the survivors succeed to the annuities of all those who die before them, the last survivor succeeding to the annuities of the whole lot. Upon the same revenue more money can always be raised by tontines than by annuities for separate lives. An annuity, with a right of survivorship, is really worth more than an equal annuity for a separate life, and from the confidence which every man naturally has in his own good fortune, the principle upon which is founded the success of all lotteries, such an annuity generally sells for something more than it is worth. In countries where it is usual for government to raise money by granting annuities, tontines are upon this account generally preferred to annuities for separate lives. The expedient which will raise most money is almost always preferred to that which is likely to bring about in the speediest manner the liberation of the public revenue.

In France a much greater proportion of the public debts consists in annuities for lives than in England. According to a memoir presented by the parliament of Bordeaux to the king in 1764, the whole public debt of France is estimated at 2400

[1] The inventor was Tonti, an Italian banker, who lived in the seventeenth century. A tontine is "an annuity shared by subscribers to a loan, with the benefit of survivorship, the annuity being increased (to the surviving subscribers) as the subscribers die, until at last the whole goes to the last survivor, or to the last two or three," according to the terms of the loan. *Cf.* Palgrave, Dictionary of Political Economy, III, 548. — ED.

millions of livres; of which the capital for which annuities for lives has been granted, is supposed to amount to 300 millions, the eighth part of the whole public debt. The annuities themselves are computed to amount to 30 millions a year, the fourth part of 120 millions, the supposed interest of that whole debt. These estimations, I know very well, are not exact, but having been presented by so very respectable a body as approximations to the truth, they may, I apprehend, be considered as such. It is not the different degrees of anxiety in the two governments of France and England for the liberation of the public revenue which occasions this difference in their respective modes of borrowing. It arises altogether from the different views and interests of the lenders.

In England, the seat of government being in the greatest mercantile city in the world, the merchants are generally the people who advance money to government. But by advancing it they do not mean to diminish, but, on the contrary, to increase their mercantile capitals; and unless they expected to sell with some profit their share in the subscription for a new loan, they never would subscribe. But if by advancing their money they were to purchase, instead of perpetual annuities, annuities for lives only, whether their own or those of other people, they would not always be so likely to sell them with a profit. Annuities upon their own lives they would always sell with loss; because no man would give for an annuity upon the life of another, whose age and state of health are nearly the same with his own, the same price which he would give for one upon his own. An annuity upon the life of a third person, indeed, is no doubt of equal value to the buyer and the seller; but its real value begins to diminish from the moment it is granted, and continues to do so more and more as long as it subsists. It can never, therefore, make so convenient a transferable stock as a perpetual annuity, of which the real value may be supposed always the same, or very nearly the same.

In France, the seat of government not being in a great mercantile city, merchants do not make so great a proportion of the people who advance money to government. The people concerned in the finances, the farmers-general, the receivers of the taxes which are not in farm, the court bankers, etc., make the

greater part of those who advance their money in all public exigencies. Such people are commonly men of mean birth, but of great wealth, and frequently of great pride. They are too proud to marry their equals, and women of quality disdain to marry them. They frequently resolve, therefore, to live bachelors, and having neither any families of their own, nor much regard for those of their relations, whom they are not always very fond of acknowledging, they desire only to live in splendor during their own time, and are not unwilling that their fortune should end with themselves. The number of rich people besides, who are either averse to marry, or whose condition of life renders it either improper or inconvenient for them to do so, is much greater in France than in England. To such people, who have little or no care for posterity, nothing can be more convenient than to exchange their capital for a revenue, which is to last just as long, and no longer, than they wish it to do.

The ordinary expense of the greater part of modern governments in time of peace being equal or nearly equal to their ordinary revenue, when war comes, they are both unwilling and unable to increase their revenue in proportion to the increase of their expense. They are unwilling, for fear of offending the people, who, by so great and so sudden an increase of taxes, would soon be disgusted with the war; and they are unable, from not well knowing what taxes would be sufficient to produce the revenue wanted. The facility of borrowing delivers them from the embarrassment which this fear and inability would otherwise occasion. By means of borrowing they are enabled, with a very moderate increase of taxes, to raise, from year to year, money sufficient for carrying on the war, and by the practice of perpetual funding, they are enabled, with the smallest possible increase of taxes, to raise annually the largest possible sum of money. In great empires, the people who live in the capital, and in the provinces remote from the scene of action, feel, many of them, scarce any inconveniency from the war, but enjoy at their ease, the amusement of reading in the newspapers the exploits of their own fleets and armies. To them this amusement compensates the small difference between the taxes which they pay on account of the war, and those which

they had been accustomed to pay in time of peace. They are commonly dissatisfied with the return of peace, which puts an end to their amusement, and to a thousand visionary hopes of conquest and national glory, from a longer continuance of the war.

The return of peace, indeed, seldom relieves them from the greater part of the taxes imposed during the war. These are mortgaged for the interest of the debt contracted in order to carry it on. If, over and above paying the interest of this debt, and defraying the ordinary expense of government, the old revenue, together with the new taxes, produce some surplus revenue, it may perhaps be converted into a sinking fund for paying off the debt. But, in the first place, this sinking fund, even supposing it should be applied to no other purpose, is generally altogether inadequate for paying, in the course of any period during which it can reasonably be expected that peace should continue, the whole debt contracted during the war; and, in the second place, this fund is almost always applied to other purposes.

The new taxes were imposed for the sole purpose of paying the interest of the money borrowed upon them. If they produce more, it is generally something which was neither intended nor expected, and is, therefore, seldom very considerable. Sinking funds have generally arisen, not so much from any surplus of the taxes which was over and above what was necessary for paying the interest or annuity originally charged upon them, as from a subsequent reduction of that interest. That of Holland, in 1655, and that of the Ecclesiastical State, in 1685, were both formed in this manner. Hence the usual insufficiency of such funds.

During the most profound peace, various events occur which require an extraordinary expense, and government finds it always more convenient to defray this expense by misapplying the sinking fund than by imposing a new tax. Every new tax is immediately felt more or less by the people. It occasions always some murmur, and meets with some opposition. The more taxes may have been multiplied, the higher they have been raised upon every different subject of taxation; the more loudly the people complain of every new tax, the more difficult it becomes, too, either to find

out new subjects of taxation, or to raise much higher the taxes already imposed upon the old. A momentary suspension of the payment of debt is not immediately felt by the people, and occasions neither murmur nor complaint. To borrow of the sinking fund is always an obvious and easy expedient for getting out of the present difficulty. The more the public debts may have been accumulated, the more necessary it may have become to study to reduce them, the more dangerous, the more ruinous it may be to misapply any part of the sinking fund; the less likely is the public debt to be reduced to any considerable degree, the more likely, the more certainly, is the sinking fund to be misapplied toward defraying all the extraordinary expenses which occur in time of peace. When a nation is already overburdened with taxes, nothing but the necessities of a new war, nothing but either the animosity of national vengeance, or the anxiety for national security, can induce the people to submit, with tolerable patience, to a new tax. Hence the usual misapplication of the sinking fund.

In Great Britain, from the time that we had first recourse to the ruinous expedient of perpetual funding, the reduction of the public debt in time of peace has never borne any proportion to its accumulation in time of war. It was in the war which began in 1688, and was concluded by the treaty of Ryswick, in 1697, that the foundation of the present enormous debt of Great Britain was first laid.

On Dec. 31, 1697, the public debts of Great Britain, funded and unfunded, amounted to £21,515,742, 13*s*. 8½*d*. A great part of those debts had been contracted upon short anticipations, and some part upon annuities for lives; so that before Dec. 31, 1701, in less than four years, there had partly been paid off, and partly reverted to the public, the sum of £5,121,041, 12*s*. ¾*d*.; a greater reduction of the public debt than has ever since been brought about in so short a period of time. The remaining debt amounted only to £16,394,701, 1*s*. 7¼*d*.

In the war which began in 1702, and which was concluded by the treaty of Utrecht, the public debts were still more accumulated. On Dec. 31, 1714, they amounted to £53,681,076, 5*s*. 6$\frac{1}{12}$*d*. The subscription into the South Sea fund of the short and long annuities increased the capital of the public debts, so

that on Dec. 31, 1722, it amounted to £55,282,978, 1*s.* $3\frac{5}{6}$*d.* The reduction of the debt began in 1723, and went on so slowly, that on Dec. 31, 1739, during seventeen years of profound peace, the whole sum paid off was no more than £8,328,354, 17*s.* $11\frac{3}{12}$*d.*, the capital of the public debt at that time amounting to the sum of £46,954,623, 3*s.* $4\frac{7}{12}$*d.*

The Spanish war which began in 1739, and the French war which soon followed it, occasioned a further increase of the debt, which, on Dec. 31, 1748, after the war had been concluded by the treaty of Aix la Chapelle, amounted to £78,293,313, 1*s.* $10\frac{3}{4}$*d.* The most profound peace of seventeen years' continuance had taken no more than £8,328,354, 17*s.* $11\frac{3}{12}$*d.* from it. A war of less than nine years' continuance added £31,338,689, 18*s.* $6\frac{1}{6}$*d.* to it.

During the administration of Mr. Pelham, the interest of the public debt was reduced, or at least measures were taken for reducing it, from 4 to 3 per cent; the sinking fund was increased, and some part of the public debt was paid off. In 1755, before the breaking out of the late war, the funded debt of Great Britain amounted to £72,289,673. On Jan. 5, 1763, at the conclusion of the peace, the funded debt amounted to £122,603,336, 8*s.* $2\frac{1}{4}$*d.* The unfunded debt has been stated at £13,927,589, 2*s.* 2*d.* But the expense occasioned by the war did not end with the conclusion of the peace; so that though, on Jan. 5, 1764, the funded debt was increased (partly by a new loan, and partly by funding a part of the unfunded debt) to £129,586,789, 10*s.* $1\frac{3}{4}$*d.*, there still remained (according to the very well-informed author of the Considerations on the Trade and Finances of Great Britain) an unfunded debt, which was brought to account in that and the following year, of £9,975,017, 12*s.* $2\frac{15}{44}$*d.* In 1764, therefore, the public debt of Great Britain, funded and unfunded together, amounted, according to this author, to £139,516,807, 2*s.* 4*d.* The annuities for lives, too, which had been granted as premiums to the subscribers to the new loans in 1757, estimated at fourteen years' purchase, were valued at £472,500; and the annuities for long terms of years, granted as premiums likewise in 1761 and 1762, estimated at $27\frac{1}{2}$ years' purchase, were valued at £6,826,875. During a peace of about seven years' continuance, the prudent and truly

patriot administration of Mr. Pelham was not able to pay off an old debt of six millions. During a war of nearly the same continuance, a new debt of more than seventy-five millions was contracted.

On Jan. 5, 1775, the funded debt of Great Britain amounted to £124,996,086, 1*s.* 6¼*d.* The unfunded, exclusive of a large civil list debt, to £4,150,236, 3*s.* 11⅞*d.* Both together, to £129,146,322, 5*s.* 6*d.* According to this account, the whole debt paid off during eleven years' profound peace amounted only to £10,415,474, 16*s.* 9⅞*d.* Even this small reduction of debt, however, has not been all made from the savings out of the ordinary revenue of the state. Several extraneous sums, altogether independent of that ordinary revenue, have contributed toward it. . . . The debt, therefore, which since the peace has been paid out of the savings from the ordinary revenue of the state, has not, one year with another, amounted to half a million a year. The sinking fund has, no doubt, been considerably augmented since the peace, by the debt which has been paid off, by the reduction of the redeemable four per cents to three per cents, and by the annuities for lives which have fallen in; and, if peace were to continue, a million, perhaps, might now be annually spared out of it toward the discharge of the debt. Another million, accordingly, was paid in the course of last year; but at the same time, a large civil list debt was left unpaid, and we are now involved in a new war, which in its progress, may prove as expensive as any of our former wars.[1] The new debt, which will probably be contracted before the end of the next campaign, may perhaps be nearly equal to all the old debt which had been paid off from the savings out of the ordinary revenue of the state. It would be altogether chimerical, therefore, to expect that the public debt should ever be completely discharged by any savings which are likely to be made from that ordinary revenue as it stands at present.

[1] It has proved more expensive than any of our former wars; and has involved us in an additional debt of more than 100 millions. During a profound peace of eleven years, little more than 10 millions of debt was paid; during a war of seven years, more than 100 millions was contracted. (This note was added by Smith to the third edition of the Wealth of Nations, which appeared in 1784. The total British debt in 1783 had risen to £238,000,000. By 1816 the wars with France had increased it to about £876,000,000, the highest point ever reached. — ED.)

CHAPTER XXI

THE NATURE AND ECONOMIC EFFECTS OF PUBLIC DEBTS

72. Early Optimistic Theories. — The earliest writers upon public debts generally held excessively optimistic or pessimistic views concerning their effects. Bishop Berkeley suggested that the public funds of Great Britain were to be considered "a mine of gold";[1] and Melon, a French mercantilist, declared:[2] "The debts of a state are debts owed by the right hand to the left, by which the body will be in no way weakened if it has the necessary nourishment and is able to distribute it."

But most, if not all, other panegyrists of public borrowing were outdone by Isaac Pinto, a Dutch merchant of Portuguese descent, who wrote:[3]

> I say that the national debt[4] has enriched the nation. Here is the way I prove it. At every loan the government of England, by granting the creditors the proceeds of certain taxes which are pledged to pay the interest, creates a new, artificial capital which did not exist before and now becomes permanent, fixed, and solid. This capital, by the agency of credit, circulates to the advantage of the public as if it were an actual sum of money by which the state had been enriched. Let us take, for example, the twelve millions Great Britain borrowed in 1760, and see what became of them. Is it not true that they were spent in great part within the nation itself? It is only the subsidies to other states and a part of the sums spent in Germany which were a pure loss. I say a part because even in

[1] The Querist, No. 233 (1735–37).

[2] Essai politique sur le commerce, ch. 23 (1734).

[3] Traité de la circulation et du crédit (1771).

[4] Pinto is here writing of the British debt. — Ed.

the war on the continent the English nation profited by various contracts for supplies and by the English subjects thereby given employment. Besides when they spent their money in Germany, they were simply fertilizing a land from which they draw gain through their commerce. The wealth of Germany redounds always to the profit of the trading nations. But I confine myself to the mere observation that it is incontestable that a great part of this loan has been employed and kept in circulation in the nation itself. England, therefore, will have saved a great part of these twelve millions diffused and absorbed in the nation itself; and furthermore the moneyed capital of the creditors — who are, in greater part, Englishmen — will be augmented by twelve millions which did not formerly exist.

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The enormous sum which composes the national debt has never existed at any one time; the magic of credit and of the circulation of money has produced this mass of wealth by successive operations with the same coins. . . . The existing supply of specie suffices to give each part of the public funds its intrinsic value as it comes into the market, without exceeding the limits of an easy and useful circulation. Public funds are the magnets which draw money; what I say is literally true. Here is the way in which possessors of former issues of government securities proceed when they undertake to make new loans to the government. Not only will they obtain some money in England by selling at a somewhat lower figure the consolidated annuities[1] they hold; but also, by offering these annuities as security, they will be able to arrange with foreign capitalists to obtain the large sums which the credit of individuals would not command. By this latter expedient they will gather in for some time a great deal of money from other countries, and may keep it until the circulation has had time to gain an equilibrium and the new loans can be distributed among a large number of purchasers. There is the solution of this great problem or phenomenon of finance. Every one was surprised, and even astonished, to see England borrow twelve millions annually for

[1] The consolidated 3 per cent stock, established in 1751, was long the principal part of the British debt. Hence the term "consols." — Ed.

a series of years. This was done by means of former issues of the government, with the aid of credit and the monetary circulation.

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Reflect then on these principles — the nature, the essence, and the effects of public loans when properly made and employed. You will find that they effectively enrich the state and do not impoverish it; that they double the moneyed capital, and, consequently, the power of contracting more loans.

Pinto did not go so far as to think that this process of creating wealth by public borrowing could continue indefinitely. He said, in fact, a country could "accumulate too great a debt" and thereby embarrass itself. But he insisted that, within limits, public debt is an addition to the wealth of a nation, and, therefore, should never be wholly extinguished:

It follows from all I have just said that, even if England could, thanks to a long peace, the operation of her sinking fund, and the growth of her commerce, succeed in paying off the whole of her national debt, she ought not to do it. It would be very harmful to that kingdom not to preserve at least sixty millions sterling of its artificial riches, the utility and necessity of which I have demonstrated.

73. The Views of Alexander Hamilton. — Views similar to those of Pinto's were sometimes expressed by Alexander Hamilton, who, as secretary of the treasury, was obliged to give much study to the subject of public debts. Perhaps the most extreme statement made by Hamilton was the following:[1]

Trace the progress of a public debt in a particular case. The government borrows of an individual \$100 in specie, for which it gives its funded bonds. These \$100 are expended on some branch of the public service. It is evident they are not annihilated; they only pass from the individual who lent, to the individual or individuals to whom the government has disbursed

[1] Lodge's edition of Hamilton's works, VII, 407–408.

them. They continue, in the hands of their new masters, to perform their usual functions, as capital. But besides this, the lender has the bonds of the government for the sum lent. These, from their negotiable and easily vendible nature, can at any moment be applied by him to any useful or profitable undertaking which occurs; and thus the credit of the government produces a new and additional capital, equal to $100, which, with the equivalent for the interest on that sum, temporarily diverted from other employments while passing into and out of the public coffers, continues its instrumentality as a capital, while it remains not reimbursed.

In his celebrated Report on Public Credit, in 1790, Hamilton advanced the same argument, although perhaps more moderately, in favor of funding the mass of debts inherited from the old Confederation. He said:[1]

It is a well-known fact, that, in countries in which the national debt is properly funded, and an object of established confidence, it answers most of the purposes of money. Transfers of stock, or public debt, are there equivalent to payments in specie; or, in other words, stock, in the principal transactions of business, passes current as specie. The same thing would, in all probability, happen here, under the like circumstances.

The benefits of this are various and obvious:

First. Trade is extended by it; because there is a larger capital to carry it on, and the merchant can, at the same time, afford to trade for smaller profits; as his stock, which, when unemployed, brings him in an interest from the government, serves him also as money when he has a call for it in his commercial operations.

Secondly. Agriculture and manufactures are also promoted by it; for the like reason, that more capital can be commanded to be employed in both; and because the merchant, whose enterprise in foreign trade gives to them activity and extension, has greater means for enterprise.

Thirdly. The interest of money will be lowered by it; for this is always in a ratio to the quantity of money, and to the

[1] Works, II, 52 *et seq.*

quickness of circulation. This circumstance will enable both the public and individuals to borrow on easier and cheaper terms.

And, from the combination of these effects, additional aids will be furnished to labor, to industry, and to arts of every kind. But these good effects of a public debt are only to be looked for when, by being well funded, it has acquired an adequate and stable value; till then, it has rather a contrary tendency. The fluctuation and insecurity incident to it in an unfunded state, render it a mere commodity, and a precarious one. As such, being only an object of occasional and particular speculation, all the money applied to it is so much diverted from the more useful channels of circulation, for which the thing itself affords no substitute; so that, in fact, one serious inconvenience of an unfunded debt is, that it contributes to the scarcity of money.

This distinction, which has been little, if at all attended to, is of the greatest moment; it involves a question immediately interesting to every part of the community, which is no other than this: Whether the public debt, by a provision for it on true principles, shall be rendered a substitute for money; or whether, by being left as it is, or by being provided for in such a manner as will wound these principles, and destroy confidence, it shall be suffered to continue as it is — a pernicious drain of our cash from the channels of productive industry.

The effect which the funding of the public debt, on right principles, would have upon landed property, is one of the circumstances attending such an arrangement, which has been least adverted to, though it deserves the most particular attention. The present depreciated state of that species of property is a serious calamity. The value of cultivated lands, in most of the states, has fallen, since the Revolution, from 25 to 50 per cent. In those further south, the decrease is still more considerable. Indeed, if the representations continually received from that quarter may be credited, lands there will command no price which may not be deemed an almost total sacrifice. This decrease in the value of lands ought, in a great measure, to be attributed to the scarcity of money; consequently, whatever produces an augmentation of the moneyed capital of the country must have a proportional effect in raising that value. The

beneficial tendency of a funded debt, in this respect, has been manifested by the most decisive experience in Great Britain.[1]

At another time, after restating his belief that a funded debt operates as capital, he proceeded to make some important qualifications of the doctrine:[2]

The effect of a funded debt, as a species of capital, has been noticed upon a former occasion; but a more particular elucidation of the point seems to be required by the stress which is here laid upon it. This shall accordingly be attempted.

Public funds answer the purpose of capital, from the estimation in which they are usually held by moneyed men; and consequently from the ease and dispatch with which they can be turned into money. This capacity of prompt convertibility into money causes a transfer of stock to be, in a great number of cases, equivalent to a payment in coin; and where it does not happen to suit the party who is to receive to accept a transfer of stock, the party who is to pay is never at a loss to find elsewhere a purchaser of his stock, who will furnish him, in lieu of it, with the coin of which he stands in need.

Hence, in a sound and settled state of the public funds, a man possessed of a sum in them can embrace any scheme of business which offers, with as much confidence as if he were possessed of an equal sum in coin.

* * * * * * *

In the question under discussion, it is important to distinguish between an absolute increase of capital, or an accession of real wealth, and an artificial increase of capital, as an engine of business, or as an instrument of industry and commerce. In the first sense, a funded debt has no pretensions to being deemed

[1] Yet, Hamilton did not go so far as to say, as Pinto did, that the debt should never be wholly paid off. He said, in fact: "Persuaded as the secretary is that the proper funding of the present debt will render it a national blessing, yet he is so far from acceding to the position, in the latitude in which it is sometimes laid down, that 'public debts are public benefits'—a position inviting to prodigality, and liable to dangerous abuse—that he ardently wishes to see it incorporated, as a fundamental maxim, in the system of public credit in the United States, that the creation of debt should always be accompanied with the means of extinguishment. This he regards as the true secret for rendering public credit immortal."

[2] Works, III, 346–347.

an increase of capital;[1] in the last, it has pretensions which are not easy to be controverted. Of a similar nature is bank credit, and, in an inferior degree, every species of private credit.

But though a funded debt is not, in the first instance, an absolute increase of capital, or an augmentation of real wealth, yet, by serving as a new power in the operations of industry, it has, within certain bounds, a tendency to increase the real wealth of a community; in like manner, as money borrowed by a thrifty farmer to be laid out in the improvement of his farm may, in the end, add to his stock of real riches.

There are respectable individuals, who, from a just aversion to an accumulation of public debt, are unwilling to concede to it any kind of utility; who can discern no good to alleviate the ill with which they suppose it pregnant; who cannot be persuaded that it ought, in any sense, to be viewed as an increase of capital, lest it should be inferred that the more debt, the more capital, the greater the burdens, the greater the blessings of the community.

But it interests the public councils to estimate every object as it truly is; to appreciate how far the good in any measure is compensated by the ill, or the ill by the good: either of them is seldom unmixed.

Neither will it follow that an accumulation of debt is desirable, because a certain degree of it operates as capital. There may be a plethora in the political as in the natural body. There may be a state of things in which any such artificial capital is unnecessary. The debt, too, may be swelled to such a size as that the greatest part of it may cease to be useful as a capital, serving only to pamper the dissipation of idle and dissolute individuals; as that the sums required to pay the interest upon it may become oppressive, and beyond the means which a government can employ, consistently with its tranquillity, to raise them; as that the resources of taxation, to face the debt, may have been strained too far to admit of extensions adequate to exigencies which regard the public safety. Where this critical point is

[1] This statement offers the sharpest contrast to the proposition laid down by Hamilton in the first extract here given. It is not possible to reconcile all of his remarks about public credit. — Ed.

cannot be pronounced; but it is impossible to believe that there is not such a point.

74. National Debts as a "National Blessing." — During the Civil War our government frequently had difficulty in marketing its bonds upon the terms prescribed by Congress; and on several occasions employed a Philadelphia banker, Mr. Jay Cooke, as general subscription agent, to sell the bonds to investors. Mr. Cooke engaged a large number of sub-agents, and pushed vigorously the sale of the bonds. In the course of this work he published and distributed broadcast a pamphlet in which the national debt is represented as a national blessing. The following extracts from this pamphlet[1] are now presented:

We lay down the proposition that our national debt, made permanent and rightly managed, will be a national blessing.

THE BURTHEN OF INTEREST THE MEASURE OF A DEBT — NOT THE PRINCIPAL

In studying these Permanent Debts, and discussing the policy of maintaining them, or discharging them by payment, the mind should free itself from the tyranny of words. Great Britain is in debt to Great Britain. Great Britain does, indeed, owe Great Britain four thousand millions of dollars. The burthen of the debt crushes the mind in contemplation of it. But its vastness is not the measure of the obligation — for there is no engagement on the part of the debtor kingdom to pay the principal of the debt, and little if any expectation, and less desire on the part of its creditor subjects that it shall be paid. The principal of the debt being thus removed from our educated idea of a legal burthen, and of the necessity to discharge a pecuniary obligation, ceases to represent the burthen. The interest of the debt only becomes the measure of its burthen. Great Britain does owe to Great Britain confessedly four thousand millions. But practically, and by consent and harmonious arrangement,

[1] How Our National Debt may be a National Blessing, by Samuel Wilkeson. Issued by Jay Cooke (Philadelphia, 1865).

Great Britain owes to Great Britain only one hundred and twenty-seven millions of dollars a year. And that is a very small debt for the proprietors and workmen of the "Workshop of the world" to owe to each other. . . .

Such, too, should be the regard of our Debt. The United States will owe, mostly to the people of the United States, one hundred and sixty-five millions of dollars a year. The burthen nominally $86.72 upon every citizen, and less than that of the British debt, unlike that of Great Britain, will every year rapidly diminish by the rapid increase of our population by immigration and natural growth, and by the rapid augmentation of our wealth. For, among the other blessings of our War will probably be the transfer of the Workshop of the world, from England to America.

The British Debt added Four Thousand Millions to Previous British Capital

The Englishman who has £20,000 in 3 per cent consols at his banker's, and only ten guineas in his pocket, and who gives assent to a proposal made to him to go mine for coal on Vancouver's Island, has got £20,000 in cash to go into the operation. He knows that positively. The world knows it. British consols are cash capital. This cannot be controverted. And the four thousand millions of British debt is national cash capital to the industry and commerce of Great Britain. For half a century this seemingly and nominally huge and burthensome debt has served to vitalize the manufacturing and trading genius of the English people, and as money, has enabled the British to do for that long time the marine carrying for the world, and to make for the world, cloth, iron, steel, tin, and hardware. This enormous mass of capital, infused into the business of England at the close of her twenty-two years' war with the French Republic and Empire — almost always of par with gold — convertible daily and hourly into gold — accepted as gold in all transactions, was the source of that prodigious development of mechanical industry and accumulation of wealth, which so suddenly bore upward the English after the battle of Waterloo to the command of the trade and finances of the globe.

It was not the industry, persistency, and frugality of the British people — it was not their insular position — it was not their coals nor their iron stone that gave them supremacy on the ocean and in the money markets and trading exchanges of both hemispheres. Their insular position was against them. Their limited island territory was unfavorable to empire. Their want of space and their climate made them dependent upon other countries for their bread. They became supreme as merchants, manufacturers, and money lenders, simply because their national debt added four thousand millions of capital to their previously acquired wealth, and simply because this vast infusion of wealth, which had every business virtue of standard coin, spurred the industry of the island, developed its mineral resources, invented and put in motion a vast mass of machinery which spun, wove, and hammered for the world, and undersold the world, and sent the world to London to pay debt and to borrow money. What place among the cities of the world would not a permanent American debt of four thousand millions give New York?

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Our Debt just so much Capital added to our Wealth

It is precisely so with the War Debt of the United States. Seven-Thirties are available for any enterprise to which unoccupied lands, undeveloped mines, unestablished arts, and unseized commerce, invite Americans. They are cash capital, literally, absolutely, and without figure of speech. Practically they are cash in bank and cash in the pocket. The artificial measures of their value which Stock Exchanges have succeeded in instituting, at times nominally gave fluctuation to their worth as they lie in the bureau drawers of farmers. But in reality the depreciation of Wall Street does not whittle off the thousandth part of a hair's breadth from that worth. Those farmers know that they are a first bond and mortgage upon all the United States, and on all the people in the United States, and upon their children, and their children's children. But whether 3 per cent above par or 1 per cent above par, holders of this War Debt of Three Thousand Millions can at any day and any

hour, from San Francisco to New York, and from Portland to New Orleans, convert it into cash.

The Funded Debt of the United States is the addition of three thousand millions of dollars to the previously realized wealth of the nation. It is three thousand millions added to its available active capital. To pay this debt would be to extinguish this capital and to lose this wealth. To extinguish this capital and lose this wealth would be an inconceivably great national misfortune.

Our National Debt the Bond of Our Union

This, our National War Debt, should be held forever in place as the political tie of the states and the bond forever of a fraternal nationality. It will give a common interest in the Union that nothing else can give. It will impart to a co-partnership between thirty-five millions of people the unity of feeling arising from a community of interest in a co-partnership capital of three thousand millions of dollars. Tied to the Union by the Union debt, nor Western states, nor Southern states — states beyond the Rocky Mountains nor states by the Atlantic Sea — states that plant nor states that weave — states that mine nor states that smelt and hammer, can ever find inducement in sectional interests to draw asunder from each other. . . .

Our National Debt Protection to our National Industry

Our National Debt should be held firmly in place as the foundation of a system of diversified national industry which shall relieve us from dependence upon Europe — shall give us the near and cheap home market instead of the distant and costly foreign market — shall double the profits of farming by doubling the markets for farm products — shall swell the class that is devoted to Agriculture, which is the sheet anchor of Democracies — shall free man by freeing Labor, by giving it many markets in which to sell itself to competing bidders. The maintenance of our National Debt is Protection. The destruction of it by payment is bondage again to the manufacturers of Europe.

75. The Views of Adam Smith. — A much less favorable view [1] of the nature and effects of a public debt was taken by Adam Smith who wrote: [2]

The public funds of the different indebted nations of Europe, particularly those of England, have by one author been represented as the accumulation of a great capital superadded to the other capital of the country, by means of which its trade is extended, its manufactures multiplied, and its lands cultivated and improved much beyond what they could have been by means of that other capital only. He does not consider that the capital which the first creditors of the public advanced to government, was, from the moment in which they advanced it, a certain portion of the annual produce turned away from serving in the function of a capital to serve in that of a revenue; from maintaining productive laborers to maintain unproductive ones, and to be spent and wasted, generally in the course of the year, without even the hope of any future reproduction. In return for the capital which they advanced they obtained, indeed, an annuity in the public funds in most cases of more than equal value. This annuity, no doubt, replaced to them their capital, and enabled them to carry on their trade and business to the same, or, perhaps, to a greater extent than before; that is, they were enabled either to borrow of other people a new capital upon the credit of this annuity, or by selling it, to get from other people a new capital of their own, equal or superior to that which they had advanced to government. This new capital, however, which they in this manner either bought or borrowed of other people, must have existed in the country before, and must have been employed as all capitals are, in maintaining productive labor. When it came into the hands of those who had advanced their money to government, though it was in some respects a new capital to

[1] Hume and others had already expressed unfavorable views. Hume, for instance, argued that public borrowing, (1) caused undue concentration of population and wealth at the capital; (2) tended, so far as public stocks served as credit money, to drive gold and silver out of the country; (3) caused injurious increase of taxes; (4) made a country tributary to foreigners in case any large amount of its debt was held in other lands; and (5) enabled fundholders to live a "useless and inactive life" at the expense of the industrious taxpayers. Essay on Public Credit.

[2] Wealth of Nations, Bk. V, ch. 3.

them, it was not so to the country; but was only a capital withdrawn from certain employments in order to be turned toward others. Though it replaced to them what they had advanced to government, it did not replace it to the country. Had they not advanced this capital to government, there would have been in the country two capitals, two portions of the annual produce instead of one, employed in maintaining productive labor.

When for defraying the expense of government a revenue is raised within the year from the produce of free or unmortgaged taxes, a certain portion of the revenue of private people is only turned away from maintaining one species of unproductive labor toward maintaining another. Some part of what they pay in those taxes might, no doubt, have been accumulated into capital, and consequently employed in maintaining productive labor, but the greater part would probably have been spent, and consequently employed in maintaining unproductive labor. The public expense, however, when defrayed in this manner, no doubt hinders more or less the further accumulation of new capital; but it does not necessarily occasion the destruction of any actually existing capital.

When the public expense is defrayed by funding, it is defrayed by the annual destruction of some capital which had before existed in the country; by the perversion of some portion of the annual produce which had before been destined for the maintenance of productive labor, toward that of unproductive labor.[1]

[1] Elsewhere (Bk. II, ch. 3) Smith had defined productive and unproductive labor as follows:

"There is one sort of labor which adds to the value of the subject upon which it is bestowed: there is another which has no such effect. The former, as it produces a value, may be called productive; the latter, unproductive labor. Thus the labor of a manufacturer adds, generally, to the value of the materials which he works upon, that of his own maintenance and of his master's profit. The labor of a menial servant, on the contrary, adds to the value of nothing. Though the manufacturer has his wages advanced to him by his master, he, in reality, costs him no expense, the value of those wages being generally restored, together with a profit, in the improved value of the subject upon which his labor is bestowed. But the maintenance of a menial servant never is restored. A man grows rich by employing a multitude of manufacturers: he grows poor by maintaining a multitude of menial servants. The labor of the latter, however, has its value, and deserves its reward as well as that of the former. But the labor of the manufacturer fixes and realizes itself in some particular subject or vendible commodity, which lasts for some time at least after that labor is

As in this case, however, the taxes are lighter than they would have been, had a revenue sufficient for defraying the same expense been raised within the year, the private revenue of individuals is necessarily less burdened, and consequently their ability to save and accumulate some part of that revenue into capital is a good deal less impaired. If the method of funding destroy more old capital, it at the same time hinders less the accumulation or acquisition of new capital, than that of defraying the public expense by a revenue raised within the year. Under the system of funding, the frugality and industry of private people can more easily repair the breaches which the waste and extravagance of government may occasionally make in the general capital of the society.

It is only during the continuance of war that the system of funding has this advantage over the other system. Were the expense of war to be defrayed always by a revenue raised within the year, the taxes from which that extraordinary revenue was drawn would last no longer than the war. The ability of private people to accumulate, though less during the war, would have been greater during the peace than under the system of funding. War would not necessarily have occasioned the destruction of any old capitals, and peace would have occasioned the accumulation of many more new. Wars would in general be more speedily concluded and less wantonly undertaken. The people feeling, during the continuance of the war, the complete burden of it, would soon grow weary of it, and government, in order to humor them, would not be under the necessity of carrying it on longer than it was necessary to do so. The foresight of the heavy and unavoidable burdens of war would hinder the people from wantonly calling for it when there was no real or solid interest to fight for. The seasons during which the ability of private people to accumulate was somewhat

past. It is, as it were, a certain quantity of labor stocked and stored up to be employed, if necessary, upon some other occasion. That subject, or what is the same thing, the price of that subject, can afterward, if necessary, put into motion a quantity of labor equal to that which had originally produced it. The labor of the menial servant, on the contrary, does not fix or realize itself in any particular subject or vendible commodity. The services of the menial generally perish in the very instant of their performance, and seldom leave any trace of value behind them, for which an equal quantity of service could afterward be procured." — ED.

impaired, would occur more rarely, and be of shorter continuance. Those, on the contrary, during which that ability was in the highest vigor, would be of much longer duration than they can well be under the system of funding.

When funding, besides, has made a certain progress, the multiplication of taxes which it brings along with it sometimes impairs as much the ability of private people to accumulate even in time of peace, as the other system would in time of war. The peace revenue of Great Britain amounts at present to more than ten millions a year. If free and unmortgaged, it might be sufficient, with proper management, and without contracting a shilling of new debt, to carry on the most vigorous war. The private revenue of the inhabitants of Great Britain is at present as much incumbered in time of peace, their ability to accumulate it as much impaired, as it would have been in the time of the most expensive war, had the pernicious system of funding never been adopted.

In the payment of the interest of the public debt, it has been said, it is the right hand which pays the left. The money does not go out of the country. It is only a part of the revenue of one set of the inhabitants which is transferred to another; and the nation is not a farthing the poorer. This apology is founded altogether in the sophistry of the mercantile system, and after the long examination which I have bestowed upon that system, it may perhaps be unnecessary to say anything further about it. It supposes that the whole public debt is owing to the inhabitants of the country, which happens not to be true; the Dutch, as well as several other foreign nations, having a very considerable share in our public funds. But though the whole debt were owing to the inhabitants of the country, it would not upon that account be less pernicious.

Land and capital stock are the two original sources of all revenue, both private and public. Capital stock pays the wages of productive labor, whether employed in agriculture, manufactures, or commerce. The management of those two original sources of revenue belongs to two different sets of people; the proprietors of land, and the owners or employers of capital stock.

The proprietor of land is interested, for the sake of his own

revenue, to keep his estate in as good condition as he can, by building and repairing his tenants' houses, by making and maintaining the necessary drains and inclosures, and all those other expensive improvements which it properly belongs to the landlord to make and maintain. But by different land taxes the revenue of the landlord may be so much diminished; and by different duties upon the necessaries and conveniences of life, that diminished revenue may be rendered of so little real value, that he may find himself altogether unable to make or maintain those expensive improvements. When the landlord, however, ceases to do his part, it is altogether impossible that the tenant should continue to do his. As the distress of the landlord increases, the agriculture of the country must necessarily decline.

When, by different taxes upon the necessaries and conveniences of life, the owners and employers of capital stock find that whatever revenue they derive from it will not, in a particular country, purchase the same quantity of those necessaries and conveniences which an equal revenue would in almost any other, they will be disposed to remove to some other. And when, in order to raise those taxes, all or the greater part of merchants and manufacturers, that is, all or the greater part of the employers of great capitals, come to be continually exposed to the mortifying and vexatious visits of the taxgatherers, this disposition to remove will soon be changed into an actual removal. The industry of the country will necessarily fall with the removal of the capital which supported it, and the ruin of trade and manufactures will follow the declension of agriculture.

To transfer from the owners of those two great sources of revenue, land and capital stock, from the persons immediately interested in the good condition of every particular portion of land, and in the good management of every particular portion of capital stock, to another set of persons (the creditors of the public, who have no such particular interest), the greater part of the revenue arising from either, must, in the long run, occasion both the neglect of land, and the waste or removal of capital stock. A creditor of the public has, no doubt, a general interest in the prosperity of the agriculture, manufactures, and commerce of the country; and consequently in the good con-

dition of its lands, and in the good management of its capital stock. Should there be any general failure or declension in any of these things, the produce of the different taxes might no longer be sufficient to pay him the annuity or interest which is due to him. But a creditor of the public, considered merely as such, has no interest in the good condition of any particular portion of land, or in the good management of any particular portion of capital stock. As a creditor of the public he has no knowledge of any such particular portion. He has no inspection of it. He can have no care about it. Its ruin may in some cases be unknown to him, and cannot directly affect him.

The practice of funding has gradually enfeebled every state which has adopted it. The Italian republics seem to have begun it. Genoa and Venice, the only two remaining which can pretend to an independent existence, have both been enfeebled by it. Spain seems to have learned the practice from the Italian republics, and (its taxes being probably less judicious than theirs) it has, in proportion to its natural strength, been still more enfeebled. The debts of Spain are of very old standing. It was deeply in debt before the end of the sixteenth century, about a hundred years before England owed a shilling. France, notwithstanding all its national resources, languishes under an oppressive load of the same kind. The republic of the United Provinces is as much enfeebled by its debts as either Genoa or Venice. Is it likely that in Great Britain alone a practice, which has brought either weakness or desolation into every other country, should prove altogether innocent?

The system of taxation established in those different countries, it may be said, is inferior to that of England. I believe it is so. But it ought to be remembered, that when the wisest government has exhausted all the proper subjects of taxation, it must, in cases of urgent necessity, have recourse to improper ones. The wise republic of Holland has upon some occasions been obliged to have recourse to taxes as inconvenient as the greater part of those of Spain. Another war begun before any considerable liberation of the public revenue had been brought about, and growing in its progress as expensive as the last war, may, from irresistible necessity,

render the British system of taxation as oppressive as that of Holland, or even as that of Spain. To the honor of our present system of taxation, indeed, it has hitherto given so little embarrassment to industry, that during the course even of the most expensive wars, the frugality and good conduct of individuals seem to have been able, by saving and accumulation, to repair all the breaches which the waste and extravagance of government had made in the general capital of the society. At the conclusion of the late war, the most expensive that Great Britain ever waged, her agriculture was as flourishing, her manufactures as numerous and as fully employed, and her commerce as extensive, as they had ever been before. The capital, therefore, which supported all those different branches of industry, must have been equal to what it had ever been before. Since the peace, agriculture has been still further improved, the rents of houses have risen in every town and village of the country, a proof of the increasing wealth and revenue of the people; and the annual amount of the greater part of the old taxes, of the principal branches of the excise and customs in particular, has been continually increasing, an equally clear proof of an increasing consumption, and consequently of an increasing produce, which could alone support that consumption. Great Britain seems to support with ease a burden, which, half a century ago, nobody believed her capable of supporting. Let us not, however, upon this account rashly conclude that she is capable of supporting any burden, nor even be too confident that she could support, without great distress, a burden a little greater than what has already been laid upon her.

When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment.

(Smith then proceeds to consider such expedients as tampering with the coinage.)

76. The Views of Jean Baptiste Say. — To much the same effect, a generation later, the French economist, Say, wrote:

There is this grand distinction between an individual borrower and a borrowing government, that, in general, the former borrows capital for the purpose of beneficial employment, the latter for the purpose of barren consumption and expenditure. A nation borrows, either to satisfy an unlooked-for demand, or to meet an extraordinary emergency; to which ends, the loan may prove effectual or ineffectual; but, in either case, the whole sum borrowed is so much value consumed and lost, and the public revenue remains burdened with the interest upon it.

Melon maintains, that national debt is no more than a debt from the right hand to the left, which nowise enfeebles the body politic. But he is mistaken; the state is enfeebled, inasmuch as the capital lent to its government, having been destroyed in the consumption of it by the government, can no longer yield anybody the profit, or in other words, the interest, it might earn in the character of a productive means. Wherewith, then, is the government to pay the interest of its debt? Why, with a portion of the revenue arising from some other source, which it must transfer from the taxpayer to the public creditor for the purpose.

Before the act of borrowing, there will have been in existence two productive capitals, each of them yielding, or capable of yielding, revenue; that is to say, a capital about to be lent to the government, and a capital whereon the future taxpayers derive that revenue, which is about to be applied in satisfaction of the interest upon the capital lent. After the act of borrowing, there will remain but one of these capitals; *viz.* the latter of the two, whereof the revenue is thenceforward no longer at the disposal of its former possessors, the present taxpayers, since it must be taken in some form of taxation or other by the government, for the sake of providing the payment of interest to its creditors. The lender loses no part of his revenue: the only loser is the payer of taxes.

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National loans of every kind are attended with the universal disadvantage, of withdrawing capital from productive employment, and diverting it to the channel of barren consumption;

and, in countries where the credit of the government is at a low ebb, with the further and particular disadvantage, of raising the interest of capital. Who can be expected to lend at 5 per cent to the farmer, the manufacturer, or the merchant, while he can readily get an offer of 7 or 8 per cent from the government? That class of revenue, which has been called profit of capital, is thereby advanced in its ratio, at the expense of the consumer: the consumption falls off, in consequence of the advance in the real price of products; the productive agency of the other sources of production are less in demand, and, consequently, worse paid; and the whole community is the sufferer, with the sole exception of the capitalist.

The ability to borrow affords one main advantage to the state; *viz.* the power of apportioning the burden entailed by a sudden emergency among a great number of successive years. In the present state of public affairs, and on the present scale of international warfare, no country could support the enormous expense from its ordinary annual revenue. The larger states pay in taxation nearly as much as they are able; for economy is by no means the order of the day with them; and their ordinary expenditure seldom falls much short of the income. If the expenditure must be doubled to save the nation from ruin, borrowing is usually the only resource; unless it can make up its mind to violate all subsisting engagements, and be guilty of spoliation of its own subjects and foreigners too. The faculty of borrowing is a more powerful agent than even gunpowder; but probably the gross abuse that is made of it will soon destroy its efficacy.

Great pains have been taken, to find in the system of borrowing, as well as in taxation, some inherent advantage, beyond that of supplying the public consumption. But a close examination will expose the hopelessness of such an attempt.

It has been maintained, for instance, that the debentures and securities which form a national debt, become real and substantial values existing within the community; that the capital, of which they are the evidence or representative, is so much positive wealth, and must be reckoned as an item of the total substance of the nation. But it is not so; a written contract or security is a mere evidence, that such or such property belongs

to such an individual. But wealth consists in the property itself, and not in the parchment, by which its ownership is evidenced; therefore, *à fortiori*, a security is not even an evidence of wealth, where it does not represent an actual existing value, but when it operates as a mere power of attorney from the government to its creditor, enabling him to receive annually a specified portion of the revenue expected to be levied upon the taxpayers at large. Supposing the security to be canceled, as it might be by a national bankruptcy, would there be the least diminution of wealth in the community? Undoubtedly not. The only difference would be, that the revenue, which before went to the public creditor, would now be at the disposal of the taxpayer, from whom it used to be taken.

Those who tell us that the annual circulation is increased by the whole amount of the annual disbursements of the government, forgot that these disbursements are made out of the annual products, and are a portion of the annual revenue, taken from the taxpayer, which would have been brought into the general circulation just the same, although no such thing as national debt had existed. The taxpayer would have spent what is now spent by the public creditor; that is all.

The sale or purchase of debentures or securities is not a productive circulation, but a mere substitution of one public creditor in place of another. When these transfers degenerate into stockjobbing, that is to say, the making of a profit by the rise and fall of their price, they are productive of much mischief; in the first place, by the unproductive employment on this object of the agent of circulation, money, which is an item of the national capital; and, in the next, by procuring a gain to one person by the loss of another, which is the characteristic of all gaming. The occupation of the stockjobber yields no new or useful product; consequently, having no product of his own to give in exchange, he has no revenue to subsist upon, but what he contrives to make out of the unskillfulness or ill fortune of gamesters like himself.

A national debt has been said to bind the public creditors more firmly to the government, and make them its natural supporters by a sense of common interest; and so it does beyond all doubt. But, as this common interest may attach equally to a

bad or a good government, there is just as much chance of its being an injury as a benefit to the nation. If we look at England, we shall see a vast number of well-meaning persons induced by this motive to uphold the abuses and misgovernment of a wretched administration.

It has been further urged, that a national debt is an index of the public opinion, respecting the degree of credit which the government deserves, and operates as a motive to its good conduct and endeavor to preserve the public opinion, of which such a debt furnishes the index. This cannot be admitted without some qualification. The good conduct of government, in the eyes of the public creditors, consists in the regular payment of their own dividends; but, in the eyes of the taxpayers, it consists in spending as little as possible. The market price of stock does, indeed, furnish a tolerable index of the former kind of good conduct, but not of the latter. Perhaps it would be no exaggeration to say, that the punctual payment of the dividends, instead of being a sign of good, is in numberless instances a cloak to bad government; and, in some countries, a boon for the toleration of frequent and glaring abuses.

Another argument in favor of national debt is, that it affords a prompt investment to capital, which can find no ready and profitable employment, and thus must, at any rate, prevent its emigration. If it do so, so much the worse; it is a bait to tempt capital toward its destruction, leaving the nation burdened with the annual interest, which government must provide. It is far better that the capital should emigrate, as it would probably return sooner or later; and then its interest for the meantime will be chargeable to foreigners. A national debt of moderate amount, the capital of which should have been well and judiciously expended in useful works, might indeed be attended with the advantage of providing an investment for minute portions of capital, in the hands of persons incapable of turning them to account, who would probably keep them locked up, or spend them by driblets, but for the convenience of such an investment. This is perhaps the sole benefit of a national debt; and even this is attended with some danger, inasmuch as it enables a government to squander the national savings. For, unless the principal be spent upon objects of permanent

public benefit, as on roads, canals, or the like, it were better for the public that the capital should remain inactive, or concealed; since, if the public lost the use of it, at least it would not have to pay the interest.

Thus, it may be expedient to borrow, when capital must be spent by a government, having nothing but the usufruct at its command; but we are not to imagine, that, by the act of borrowing, the public prosperity can be advanced. The borrower, whether a sovereign or an individual, incurs an annual charge upon his revenue, besides impoverishing himself to the full amount of the principal, if it be consumed; and nations never borrow but with a view to consume outright.

77. The Views of Karl Dietzel. — The opinions of Adam Smith and of such disciples as Say had a profound influence upon the later development of financial theory. About the middle of the nineteenth century, however, a German economist, Karl Dietzel, raised a vigorous protest against the view of public debts then prevalent; and developed a theory which has had considerable influence upon later German writers. Dietzel said, in part:[1]

From Adam Smith's time down to the present a one-sided view of public loans has prevailed in financial theory, and is encountered in the work of most writers. It is based upon Smith's erroneous conception of capital and income. In brief the substance of this doctrine is as follows:

Taxes are paid out of income; loans, out of capital. If, therefore, the funds needed for extraordinary expenditures are raised by taxation, the people, as a result of their natural dislike of weakening their economic position, will restrict their consumption and endeavor to pay the taxes out of their net income. In this way the capital of the community is not diminished and industry is not disturbed; while the whole effect of the extraordinary expenditure is to cause a simple retrenchment in consumption.

If, however, the extraordinary outlays are met by loans, the funds will come from the capital of the community. By this

[1] System der Staatsanleihen, 159 *et seq.* (1855).

process the supply of capital will be reduced, and future production of wealth will be decreased. In this way society is permanently injured; for the capital thus expended is lost beyond recovery since it is destroyed in unproductive consumption which the state undertakes through its agency.

If this view were correct, the practice of public borrowing would thereby be unconditionally condemned. Fortunately the case is altogether otherwise. In Smith's view we encounter various fundamental errors of prevailing financial theory: a false conception of capital; a one-sided notion of productivity; and the arbitrary assumption of the existence of such a thing as a distinct net income.

Concerning the first two of these errors, we have already said enough; and so merely refer to the results of the previous discussion.[1] The third we have now to examine. "Taxes," it is said, "are paid out of net income," that is, out of that portion of the product of current industry which is not required for the maintenance of existing economic conditions, and which, therefore, can be used by the recipient for any purpose he pleases and will ordinarily be consumed. This doctrine rests on the erroneous conception that economic society is a mechanical contrivance which always remains the same, and in which the same factors yield every year the same result and ought to do so. Industry is conceived of as having two purposes, first, the production of goods needed to maintain the existing industrial fabric; and, second, the production of a surplus which, as net income, can be used for any purpose desired.

This view can be founded neither upon human nature as we know it nor upon the experience of practical life. The motive and purpose of all economic effort is everywhere the one effort to satisfy human needs. These needs, however, continually advance, of necessity; and for this reason, advance, progress,

[1] Dietzel had argued that Smith's conception of capital was altogether too narrow. Smith defined capital as that part of a person's "stock" which he expects to afford him a revenue. Wealth of Nations, Bk. II, ch. 1. Dietzel would make the concept so broad as to include substantially all the material and immaterial possessions of a community. He even called the state a part of the capital of society. System der Staatsanleihen, 33–75. Dietzel's second criticism, *viz.* that Smith had an erroneous notion about productivity, has been presented sufficiently in a passage which we have already quoted. See § 7. — Ed.

must be regarded as the fundamental principle of economic society.

What led men to advance beyond the first rude conditions of primitive industry, what compelled them gradually to combine their labor power and to create capital, what carried them on from that rude beginning through so many intermediate stages to the present civilization and mastery over nature, is their inherent impulse to improve their condition and to satisfy their needs ever more completely. All goods newly produced at any time have this purpose: they may be immediately consumed, or may be used in such a way that they do not yield up the satisfactions they afford until a later time.

The assumption that a part of the product is devoted to the satisfaction of necessary wants, that is, to the maintenance of existing industry, — and is, therefore, not available for any other purpose, — while the other part may be devoted to any purpose whatever, is wholly arbitrary. The same is true of the concept of free income, which is founded upon this arbitrary assumption, — free income the disposition of which is less important than the disposition of the capital previously accumulated, so that its destruction by taxation is a matter of comparatively little moment; while it is thought that to take previously accumulated capital in the form of a loan exerts a destructive influence upon industry.

The truth is that all newly produced goods are at the outset disposable capital. All are created for the same purpose, the immediate or more remote satisfaction of needs; they are already destined to be capital, and must, therefore, be considered as capital. To take away any part of them is as truly a destruction of capital, as the destruction of capital previously accumulated would be. . . .

The ongoing of industry is continuous and without a break. It is the result of ceaselessly active forces; of human activity in working over raw materials and of ever-operating natural forces. The assumption of distinct periods of production is, for this reason, a thoroughly arbitrary one, admissible only for convenience of representation and logical arrangement. It is, therefore, to be confined to these uses alone, since there is nothing in reality that corresponds to it. The moment that we try to build an

argument upon such a foundation, the assumption then leads to an arbitrary severing of the natural course of things; and error is the necessary result.

This is true of the theory of net income which, of course, rests upon the assumption of distinct periods of production, since it would be unthinkable otherwise. Net income consists of the value of all the goods produced in any period after all the costs of production have been deducted, among which is included an appropriate allowance for the support of the producers. The surplus value continually produced by industry, and called net income, is destined just as little for any sort of unproductive employment that may be desired as are the goods accumulated prior to any productive period, which are usually called capital. The first is destined for the same end as the second, namely, under the continuous influence of human labor, to be converted into goods capable of satisfying more and more completely human wants, and then to be consumed for this object. Newly produced goods form a homogeneous mass with the goods previously produced, the whole being destined to serve as the basis of the subsequent industry of the people. They have merely this advantage that, in respect to them, people are free to choose in what form they will have them applied to the production of wealth. The decision of this point will depend upon a consideration of the way in which these goods will yield the greatest advantage. If they will have a greater value when employed in a private business enterprise, then it will be disadvantageous to take them for public purposes; but it is wholly immaterial whether they were previously net income or capital.

This whole theory of Smith's is at the bottom based upon his erroneous view of governmental activity. If one looks upon the state as unproductive and considers its operations as a destruction of values, then, to be sure, this cost of maintaining the state can come only from the surplus wealth created each year, — that is, will be taken from income, — because otherwise the capital and consequently the productive power of the community must continually diminish and finally come to an end. So far, then, we can say that taxes are paid out of income. But, as we have demonstrated, taxes are really a

part of the disposable capital created each year for the purpose of being converted by society into those goods which can be obtained only in this way. The production of taxes is just as good an end of economic activity as the production of any other goods. It is, therefore, clearly inadmissible to count the goods which protect the body against cold as among the costs of maintaining industry, on the ground that they are a necessary part of a man's subsistence, and, on the other hand, set over against them as "net income" the goods which protect personal freedom and industrial activity.

Equally incorrect, then, is the other half of the doctrine of Smith, — that loans are raised from the capital of the community, and therefore impair production and injure the economic position of the people. In this proposition the inadequacy and faults of the current definition of capital come to light most forcibly. Unless we are very much mistaken, this view was suggested by the facts, that subscriptions to loans are commonly made in large sums while taxes are paid in smaller amounts, and that in ordinary life we are accustomed to call the former capital since they can at once be loaned at interest while we do not consider the latter as capital because they are usually too small to find ready investment. Where now are we to look for the capital which is withdrawn from industry when loans are made. Clearly it must be capital already devoted to production since only in this case can it affect industry in any injurious manner. But it is evident that fixed capital cannot be turned over to the state, and this forms the largest and most important part of the whole supply of capital. And circulating capital is in the main so far advanced toward its conversion into some specialized form of goods that it is adapted only to the special needs of private individuals and not to those of the state. Therefore the state can take only that part of capital which is in the form of raw materials, or materials slightly transformed, which is still free capital and not yet ready for the use of private industry. Concerning the most useful disposition of this, it is possible and necessary to make a decision.

Of course this new disposable capital, in conformity with the purpose of all economic activity, is usually destined to replace the capital that is continually consumed and to make additions

to our general store of capital. Under special conditions, however, this method of employing new disposable capital may be thoroughly inexpedient. This would be the case if, on account of decreased demand for goods or because of an urgent demand of the state for goods, individual investors find there is no demand for their capital and that goods invested under such conditions would lose their value as capital. If, in such a case, this disposable capital is transferred to the state in the form of a public loan, it is because the investor had the conviction that it would produce a greater value in this employment than it would if invested in private industry. The view of the state securing the loan was the same; and the opinion of the two parties to the transaction must be assumed to be correct. For no one can pretend to judge the value of a good more correctly than the person who exchanges it for another. The outward sign according to which the opinion of the two parties is determined, and in which it expresses itself, is the rate of interest.

The disposable capital taken by the state in this way cannot, it is true, be employed in private business enterprises. In fact no increase of such enterprises can take place, and perhaps even the present volume of industry cannot be maintained. . . . But the reason for this is not that capital has been taken away, but rather the more general circumstance, that now, as a result of special conditions, there is less need of goods adapted to the immediate satisfaction of wants, and that other goods and other employments of capital have for the time a higher value. Therefore the employment of disposable capital in private enterprises in the production of goods of the sort previously wanted, would be useless, and such capital would be lost.

If, for instance, a dangerous war breaks out, it will be out of the question to satisfy new demands for luxuries, and often it will be impossible even to satisfy the former demand. It is necessary, instead, to secure the means of protecting and preserving the goods already on hand. A large or even larger production of costly silks, for instance, would be inadvisable; and if this occurred, the producers would probably lose money. Production of silks, therefore, is suspended or decreased; and the disposable capital of silk manufacturers, which under ordinary conditions would be reinvested in this industry, is loaned to

the government. By the government it is employed in the purchase or production of cloth needed to clothe the army, or something of a similar nature. In the same way less capital is invested in making pleasure carriages, and more ammunition or army wagons are built. So, too, the breeding of driving horses is checked, and more army horses are bred.

All these investments of disposable capital serve the purpose of procuring the good which is at the moment of the greatest value, — protection against foreign enemies or the successful termination of a war that has begun. The goods invested in this manner preserve their properties as capital, for they are converted into goods which represent their value because much needed and therefore in demand.

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With this falls the theory that public loans destroy capital, the theory which we meet in the works of most writers. It is, apart from the faulty conception of capital which we mentioned above, to be considered a necessary consequence of the theory that all public consumption is unproductive. We have already discussed the falsity of this theory.

This theory is wrong not only in regard to goods which had formerly served another purpose, but are now taken for public purposes because these seem to be more important (as in the example just given,) and offer the most needed sort of employment. But it is also especially wrong in regard to goods that pass directly from the disposable capital of the society into the hands of the state rather than into private industries. Such goods had not yet been used as capital, and in reality first became such when used by the state. It is questionable, indeed, whether they would have retained their value if they had passed into the hands of private enterprises.

The doctrine that taxes and capital come out of different parts of the wealth of the society and consequently exercise different, even opposite, effects upon the welfare and development of economic society, — because the former do not impair capital while the latter do impair it, — is wholly untenable. It is based upon an arbitrary separation of things naturally similar and inseparable. Both taxes and loans flow in the same manner from the disposable capital of society, and only the purposes for

which they are employed give rise to a fundamental distinction between them.

(Dietzel then proceeds to enlarge upon the advantages of public loans. They enable governments, he says, to raise large sums of money very quickly; make it unnecessary to increase taxation to an injurious extent; encourage saving; enable a country to draw on the resources of foreign investors; enable a government to place part of an extraordinary burden upon future generations; increase production; and add to the wealth of a country. — Ed.)

CHAPTER XXII

SHOULD A NATIONAL DEBT BE PAID?

78. The Views of Mill. — The desirability of redeeming a national debt was urged by Mr. Mill as follows:[1]

When a country, wisely or unwisely, has burthened itself with a debt, is it expedient to take steps for redeeming that debt? In principle it is impossible not to maintain the affirmative. It is true that the payment of the interest, when the creditors are members of the same community, is no national loss, but a mere transfer. The transfer, however, being compulsory, is a serious evil, and the raising a great extra revenue by any system of taxation necessitates so much expense, vexation, disturbance of the channels of industry, and other mischiefs over and above the mere payment of the money wanted by the government, that to get rid of the necessity of such taxation is at all times worth a considerable effort. The same amount of sacrifice which would have been worth incurring to avoid contracting the debt, it is worth while to incur, at any subsequent time, for the purpose of extinguishing it.

Two modes have been contemplated of paying off a national debt: either at once by a general contribution,[2] or gradually by a surplus revenue. The first would be incomparably the best, if it were practicable; and it would be practicable if it could justly be done by assessment on property alone. If property bore the whole interest of the debt, property might, with great advantage to itself, pay it off; since this would be merely surrendering to a creditor the principal sum, the whole annual proceeds of which were already his by law; and would be

[1] Principles, Bk. V, ch. 7, §§ 2–3.

[2] Ricardo and others had advocated such a policy. *Cf.* Ricardo, Principles of Political Economy and Taxation, ch. 17. — Ed.

equivalent to what a landowner does when he sells part of his estate, to free the remainder from a mortgage. But property, it needs hardly be said, does not pay, and cannot justly be required to pay, the whole interest of the debt. Some indeed affirm that it can, on the plea that the existing generation is only bound to pay the debts of its predecessors from the assets it has received from them, and not from the produce of its own industry. But has no one received anything from previous generations except those who have succeeded to property? Is the whole difference between the earth as it is, with its clearings and improvements, its roads and canals, its towns and manufactories, and the earth as it was when the first human being set foot on it, of no benefit to any but those who are called the owners of the soil? Is the capital accumulated by the labor and abstinence of all former generations of no advantage to any but those who have succeeded to the legal ownership of part of it? And have we not inherited a mass of acquired knowledge, both scientific and empirical, due to the sagacity and industry of those who preceded us, the benefits of which are the common wealth of all? Those who are born to the ownership of property have, in addition to these common benefits, a separate inheritance, and to this difference it is right that advertence should be had in regulating taxation. It belongs to the general financial system of the country to take due account of this principle, and I have indicated, as in my opinion a proper mode of taking account of it, a considerable tax on legacies and inheritances. Let it be determined directly and openly what is due from property to the state, and from the state to property, and let the institutions of the state be regulated accordingly. Whatever is the fitting contribution from property to the general expenses of the state, in the same, and in no greater proportion, should it contribute toward either the interest or the repayment of the national debt.

This, however, if admitted, is fatal to any scheme for the extinction of the debt by a general assessment on the community. Persons of property could pay their share of the amount by a sacrifice of property, and have the same net income as before; but if those who have no accumulations, but only incomes, were required to make up by a single payment the equiva-

lent of the annual charge laid on them by the taxes maintained to pay the interest of the debt, they could only do so by incurring a private debt equal to their share of the public debt; while, from the insufficiency, in most cases, of the security which they could give, the interest would amount to a much larger annual sum than their share of that now paid by the state. Besides, a collective debt defrayed by taxes, has over the same debt parceled out among individuals, the immense advantage, that it is virtually a mutual insurance among the contributors. If the fortune of a contributor diminishes, his taxes diminish; if he is ruined, they cease altogether, and his portion of the debt is wholly transferred to the solvent members of the community. If it were laid on him as a private obligation, he would still be liable to it even when penniless.

When the state possesses property, in land or otherwise, which there are not strong reasons of public utility for its retaining at its disposal, this should be employed, as far as it will go, in extinguishing debt. Any casual gain, or godsend, is naturally devoted to the same purpose. Beyond this, the only mode which is both just and feasible, of extinguishing or reducing a national debt, is by means of a surplus revenue.

The desirableness, *per se*, of maintaining a surplus for this purpose does not, I think, admit of a doubt. We sometimes, indeed, hear it said that the amount should rather be left to "fructify in the pockets of the people." This is a good argument, as far as it goes, against levying taxes unnecessarily for purposes of unproductive expenditure, but not against paying off a national debt. For, what is meant by the word "fructify"? If it means anything, it means productive employment; and as an argument against taxation, we must understand it to assert, that if the amount were left with the people, they would save it, and convert it into capital. It is probable, indeed, that they would save a part, but extremely improbable that they would save the whole: while if taken by taxation, and employed in paying off debt, the whole is saved, and made productive. To the fundholder who receives the payment it is already capital, not revenue, and he will make it "fructify," that it may continue to afford him an income. The objection, therefore, is not only groundless, but the real argument is on the other side; the

amount is much more certain of fructifying if it is not "left in the pockets of the people."

It is not, however, advisable in all cases to maintain a surplus revenue for the extinction of debt. The advantage of paying off the national debt of Great Britain, for instance, is that it would enable us to get rid of the worse half of our taxation. But of this worse half some portions must be worse than others, and to get rid of those would be a greater benefit proportionally than to get rid of the rest. If renouncing a surplus revenue would enable us to dispense with a tax, we ought to consider the very worst of all our taxes as precisely the one which we are keeping up for the sake of ultimately abolishing taxes not so bad as itself. In a country advancing in wealth, whose increasing revenue gives it the power of ridding itself from time to time of the most inconvenient portions of its taxation, I conceive that the increase of revenue should rather be disposed of by taking off taxes, than by liquidating debt, as long as any very objectionable imposts remain. In the present state of England, therefore, I hold it to be good policy in the government, when it has a surplus of an apparently permanent character, to take off taxes, provided these are rightly selected. Even when no taxes remain but such as are not unfit to form part of a permanent system, it is wise to continue the same policy by experimental reductions of those taxes, until the point is discovered at which a given amount of revenue can be raised with the smallest pressure on the contributors. After this, such surplus revenue as might arise from any further increase of the produce of the taxes, should not, I conceive, be remitted, but applied to the redemption of debt. Eventually, it might be expedient to appropriate the entire produce of particular taxes to this purpose; since there would be more assurance that the liquidation would be persisted in, if the fund destined to it were kept apart, and not blended with the general revenues of the state. The succession duties would be peculiarly suited to such a purpose, since taxes paid as they are, out of capital, would be better employed in reimbursing capital than in defraying current expenditure. If this separate appropriation were made, any surplus afterward arising from the increasing produce of the other taxes, and from the saving of interest on the successive

portions of debt paid off, might form a ground for a remission of taxation.

It has been contended that some amount of national debt is desirable, and almost indispensable, as an investment for the savings of the poorer or more inexperienced part of the community. Its convenience in that respect is undeniable; but (besides that the progress of industry is gradually affording other modes of investment almost as safe and untroublesome, such as the shares or obligations of great public companies) the only real superiority of an investment in the funds consists in the national guarantee, and this could be afforded by other means than that of a public debt, involving compulsory taxation. One mode which would answer the purpose, would be a national bank of deposit and discount, with ramifications throughout the country; which might receive any money confided to it, and either fund it at a fixed rate of interest, or allow interest on a floating balance, like the joint stock banks; the interest given being, of course, lower than the rate at which individuals can borrow, in proportion to the greater security of a government investment; and the expenses of the establishment being defrayed by the difference between the interest which the bank would pay, and that which it would obtain, by lending its deposits on mercantile, landed, or other security. There are no insuperable objections in principle, nor, I should think, in practice, to an institution of this sort, as a means of supplying the same convenient mode of investment now afforded by the public funds. It would constitute the state a great insurance company, to insure that part of the community who live on the interest of their property, against the risk of losing it by the bankruptcy of those to whom they might otherwise be under the necessity of confiding it.

79. **The Views of H. C. Adams.** — This important question is discussed further by Professor H. C. Adams:[1]

The policy adopted by the United States with regard to the expungement of its obligations is not of wide acceptance. From the time that Gallatin assumed control of the federal treasury

[1] Public Debts, 240–247 (New York, D. Appleton and Company, 1887). Reprinted with consent of the author and the publishers.

to the present, the American people have manifested a strong dislike to the perpetuation of a funded debt, but in other countries this sentiment has failed to find response. It is true that England and Holland appear to appreciate the arguments for the extinction of public obligations; but the Latin peoples, whether in Europe or in South America, as well as those people of Eastern and Asiatic civilization who have come in contact with and imitate European manners, do not attach much importance to the necessity of reducing the principal of their debts. It thus appears that the advisability of debt payment admits of serious discussion.

Yet it should be clearly discerned at the beginning that this discussion does not turn upon a question of principle, but has wholly to do with methods of procedure. It is now universally admitted that a debt can only be paid out of surplus revenue, and all financiers readily accede to the proposition that financial burdens at any time imposed upon the industries of a country should be as light as possible. The real point in controversy pertains to the best way of attaining this end, a statement that may be easily understood if we consider for a moment the elements that go to make up the burden of a debt.

The constituent elements of this burden are the principal of the debt, or the amount to be paid; the annuity occasioned by the debt, or the annual interest demanded; and the industrial condition of the country, or the underpinning of the debt. This factor last mentioned should receive due recognition, since the argument in favor of perpetual indebtedness rests upon an over-estimation of its importance; and it must be conceded that the true conception of a burden of any sort brings to mind not merely the weight carried, but compares that weight with the strength of him who carries it. It is at this point that the two schools of finance part company. The one would reduce the burden of the debt by extinguishing its principal, the other would accomplish the same purpose by developing national resources.

There are two classic arguments put forth by those who defend the policy of perpetual indebtedness. It is claimed, in the first place, that the pressure of a public debt is necessarily decreased from year to year by the gradual depreciation in the value of

the monetary unit in which all obligations are expressed; this depreciation being the result of constant additions made to the amount of money material, and of continued development of the mechanism of exchange. This argument, however, does not call for extended consideration. The fact which it states as a general fact, taking into view the variations of the precious metals from century to century, cannot be denied, although there is some reason for believing that the tendency of gold to fall in value has, at the present time, received a temporary check. But without relying upon such a suggestion for our decision, it certainly seems that gradual depreciation is too tardy in its workings to be worthy of serious consideration. Before the burden of a debt, like that, for example, which the United States is bearing, could be sensibly diminished through depreciation in the value of the monetary unit, an addition of a tenth of one per cent to the annual interest payments would have extinguished the principal.

The second argument for perpetual indebtedness is worthy more serious consideration. Why, it is asked, should a people bear a high rate of taxation for the purpose of reducing the principal of a debt, when all the practical effects of debt reduction may be realized through the natural growth and prosperity of the nation? A wise policy, it is claimed, demands that the entire energy of the country be given to the development of industries, and to the increase of wealth and numbers; since the financial ability of the country may in this manner be so greatly enhanced that the pressure of the debt will cease to be felt. The experience of England is often cited in support of this view. The pressure of her debt in 1815 is computed as equivalent to 9 per cent of her yearly income; in 1880 it was observed to be less than 3 per cent; but this reduction had been effected not by the expungement of her obligations but by the growth of national wealth. The actual result, so far as debt burden is concerned, is the same as though two thirds of the principal had been paid while the amount of her wealth remained stationary. In France, also, one may discover the working of the same principle, although in this instance the pressure of the debt remained constant, or is increased very slightly, while the capital sum of her obligations has greatly

increased. Thus the capitalized sum of the French debt was in 1840 $850,000,000, in 1870 it was $2,759,000,000; but the pressure of the annual payments demanded by these debts, computed upon the national income for the respective periods, is found to be .022 and .023. That is to say, the national income of France increased at a rate nearly as rapid as that of her debt, notwithstanding the extravagances of the empire. But it should, perhaps, be added, that this favorable exhibit has been destroyed by the financial disasters occasioned by the Franco-Prussian war.

It is upon such facts as these that the common argument in support of the policy of perpetual indebtedness is based, and, so far as the facts are concerned, there is no room for controversy. But the conclusion of the argument may not be so readily accepted, for, if it can be shown that the payment of the principal of a debt has no tendency to retard the industrial development of a nation, the entire course of reasoning falls to the ground. As opposed to the idea from which this reasoning must proceed, I venture to place the following proposition, which, if maintained, will furnish an incontrovertible argument in favor of the policy which the United States has adopted:

The payment of the principal of a debt tends neither to impoverish a nation nor to retard its material development; but, on the other hand, the maintenance of the principal and the constant payment of accruing interest tend to cripple the productive capacity of any people.

The two parts of this proposition should receive separate attention, and we are led first to inquire if the industries of a country are injuriously affected by the process of payment. It is admitted by all that somewhere in the course of deficit financiering — either at the time the debt was established, or during the period that it was carried, or at the date of its payment — a loss is sustained chargeable to the adoption of the loan policy. Should one reason from the analogy of private debts, he will conclude that this burden is borne at the time when the debt is paid; for when an individual debtor clears himself from obligations, he loses control over a certain amount of capital, and consequently lessens his importance as a member of industrial society. But such reasoning cannot be applied to the state. The state is not an individual, it has no life separate from the united lives of

all citizens, and it recognizes no interest but the collective interest of society. The state is the corporate representative of all citizens, creditors as well as debtors, and is not at all interested in the proprietary residence of capital, provided only it be judiciously employed. Since, then, the payment of its own obligations effects no more than a transfer of control over capital from one set of men to another, it cannot be said that the industrial development of the country is thereby obstructed.

The position here assumed may be easily understood if one hold firmly in mind the nature of capital. Capital is subsistence fund, and he who controls it has it in his power to direct labor. It is capital which the state wants when it borrows money, and in borrowing capital it draws to its own use that which, had it not been thus appropriated, might have been applied to some productive industry under private management. The obligations which the state creates against itself are written in the language of money, because this is the most convenient language known for the expression of indebtedness; but the state has no use for money except to effect the transfer to itself of control over existing capital.

Suppose a state to borrow a billion dollars; it cannot be said that industrial society is thereby necessarily rendered any the poorer. Capital is not destroyed by the borrowing. Before the loan was filled, the nation was possessor of a certain amount of capital, distributed in a thousand funds and under the direction of a thousand wills; after the loan the nation as a whole holds the same amount of capital as before, the only difference being that control over it has passed to the state. Whether or not this operation is industrially detrimental depends upon the use to which the state puts the proceeds of its loan. If it be consumed in the prosecution of a war, the nation is impoverished to the extent of the unproductive consumption, since capital, in the form of bacon, flour, clothes, implements, mules, and the like, has been destroyed. We may, then, conclude that the injury sustained on account of a loan for war purposes is sustained at the time the loan was contracted, and is due to the fact that the state has caused a certain amount of capital to disappear without hope of recovery.

Let us now turn to the process of payment. The obligations

which the state has created against itself call for the payment of a certain amount of money. The money, which it obtains by means of taxation, is held for a moment, then transferred to the public creditors, and in this manner the state becomes absolved from its indebtedness. It would of course be incorrect to say that this transfer of money from one set of citizens to another does not in the least disturb capital, for possession of money is the evidence of ownership in capital; but it may be rightly claimed that it does not destroy capital. Before the payment, one set of individuals controlled the subsistence fund of the country to the extent of the payment; after the extinction of the debt, ownership rests with another set of individuals. The government is freed from the necessity of providing an annual sum in the form of interest, and, measured by the amount of capital in the country, the nation is in no wise impoverished. There is the same amount of food for the subsistence of laborers, and the same amount of raw stuffs upon which to set them at work. If the new masters of capital are as enterprising as the old, the nation loses nothing by the payment of its debt. This is the explanation, and in the explanation lies the defense, of the proposition that the payment of a public debt does not necessarily impoverish a nation. The injury to industrial society is worked by the destruction of capital at the time the loan was contracted; the labor required to create again the capital thus destroyed constitutes the burden imposed upon the nation; the payment of the principal of the debt is at most but a readjustment of ownership in existing capital. It is a fallacy to argue that the expungement of public obligations destroys capital.

But how is a people impoverished by the maintenance of the principal of a debt? In so far as bondholders live from the proceeds of their bonds, they form a class not immediately interested in current industries. At some time in the past they may have furnished the government with large sums of capital, thus averting the inconvenience of excessive taxation or of a sudden change in rates; and, in return for this service, they received from the government the promise of an annuity until an equivalent of the original capital should be returned. Such persons are guaranteed a living without labor.

There is but one way in which the government may escape the necessity of supporting in idleness this class, and that is by paying its members their respective claims. The bondholders would in this manner be deprived of their secured annuity, but they would in its stead hold a sum of free capital; and if they wish to continue in the enjoyment of an income from their property, they must apply their funds to some productive purpose. In this manner the country gains by bringing to bear upon industrial affairs the interested attention of those who formerly were secured a living from the proceeds of public taxes. For another reason also is the payment of a debt advantageous. No people can long retain that hopefulness so essential to the vigorous prosecution of industries if the past lays heavy claims upon the present. As a rule, they only should partake of current product who are in some way connected with present production. Carelessness and jealousy are not characteristics of efficient labor, but they are sentiments naturally engendered by the payment of taxes for the support of a favored class. It is the permanency of this payment, rather than its amount, which exerts a depressing influence upon labor, and its extinction is a first step toward the establishment of confidence and contentment. It is for such reasons as these that we conclude that the policy of debt payment vigorously prosecuted will assist rather than retard industrial development.

CHAPTER XXIII

SINKING FUNDS

80. The Theories of Dr. Price.[1] — During the eighteenth century various attempts had been made, as described by Adam Smith, to reduce the British debt by creating a sinking fund. These efforts proved ineffectual for various reasons, and finally Dr. Richard Price came forward with what was generally believed to be a demonstration of the efficacy of a permanent sinking fund inviolably pledged and applied to the extinction of a public debt. His theories found favor with the younger Pitt, and were embodied in a new sinking-fund law of 1786, known as Pitt's sinking fund. This act set aside £1,000,000 per year to be placed in the hands of sinking-fund commissioners, who were to apply it to the purchase of the national debt, and then to draw from the treasury interest on stock thus purchased and apply that to further purchases. It was intended that this should continue until the interest on the stock purchased (redeemed) and held by the commissioners should equal £4,000,000; when, with the £1,000,000 annual appropriation, the sinking fund would amount to £5,000,000 a year.[2]

The theory upon which this was done is most clearly set forth by Dr. Price in his Appeal to the Public on the Subject of the National Debt. The gist of his argument is contained in the following extracts:

[1] Dr. Richard Price (1723–91) was a dissenting clergyman and a well-known writer upon a variety of subjects. His principal works dealing with the theory of sinking funds were: Observations on Reversionary Payments (1769) and An Appeal to the Public on the Subject of the National Debt (second edition, 1772). We quote from the latter publication.

[2] See Palgrave, Dictionary of Political Economy, III, 405 *et seq.*

A Sinking Fund, according to the most *general* idea of it, signifies "any *Saving* or *Surplus*, set apart from the rest of the annual income, and appropriated to the purpose of paying off or sinking debts."

There are *three ways* in which a kingdom may apply such a saving.

1st. The *interests* disengaged from time to time by the payments made with it, may be themselves applied to the payment of the public debt.

Or, *2dly*, They may be spent on current services.

Or, *3dly*, They may be immediately annihilated by abolishing the taxes charged with them.

In the first way of employing a *Sinking Fund*, it becomes a fund always increasing itself. Every new *interest* disengaged by it, containing the same powers with it, and joining its operation to it; and the same being true of every interest disengaged by every interest, it must act, not merely as an *increasing* force, but with a force the *increase* of which is continually accelerated; and which, therefore, however small at first, must in time, become equal to *any* effect. In the *second* way of applying a *Sinking Fund*, it admits of no increase, and must act forever with the same force. — In other words, A *Sinking Fund*, according to the first method of applying it, is, if I may be allowed the comparison, like a grain of corn sown, which, by having its produce sown and the produce of that produce and so on, is capable of an increase that will soon stock a province or support a kingdom. — On the contrary. A *Sinking Fund*, according to the second way of applying it, is like a seed the produce of which is consumed; and which, therefore, can be of no further use, and has all its powers destroyed.

The *former*, be its income at first ever so much exceeded by the new debts incurred annually, will soon become superior to them and cancel them. — The *latter*, if at first inferior to the new debts incurred annually, will forever remain so; and a state that has no other provision for the payment of its debts, will be always accumulating them until it sinks.

What has been now said of the *second* mode of applying a fund is true in a higher degree of the *third*. For in this case, the disengaged interests, instead of being either added to the

fund, or spent from year to year on useful services, are immediately given up.

In short, a fund of the *first* sort is money bearing *compound* interest — A fund of the *second* sort is money bearing *simple* interest — And a fund of the *third* sort is money bearing *no* interest — The difference between them is, therefore, properly infinite. And this is so evident, that I cannot go on with this explanation without some reluctance. I will, however, rely on the candour of those who must be already abundantly convinced, while I endeavour to illustrate these observations by the following example.

Let us suppose a nation to be capable of setting apart the annual sum of 200,000*l.* as a fund for keeping the debts it is continually incurring in a course of redemption; and let us consider what its operation will be, in the *three* ways of applying it which I have described, supposing the public debts to bear an interest of 5 *per cent* and the period of operation 86 years.

A debt of 200,000*l.* discharged the first year, will disengage for the public an annuity of 10,000*l.* If this annuity, instead of being spent on current services, is added to the fund, and both employed in paying debts, an annuity of 10,500*l.* will be disengaged the *second* year, or of 20,500*l.* in both years. And this again, added to the fund the *third* year, will increase it to 220,500*l.*; with which an annuity will then be disengaged of 11,025*l.*; and the *sum* of the disengaged annuities will be 31,525*l.*: which added to the fund the *fourth* year, will increase it to 231,525*l.*, and enable it then to disengage an annuity of 11,576*l.* 5*s.* and render the *sum* of the disengaged annuities in *four* years, 43,101*l.* 5*s.* — Let any one proceed in this way, and he may satisfy himself, that the *original Fund*, together with the *sum of the annuities disengaged*, will increase faster and faster every year, till, in 86 years, the *fund* becomes 13,283,414*l.* and the *sum* of the disengaged annuities 13,083,414*l.* — The full value, therefore, at 5 *per cent.* of an annuity of 13,083,414*l.* will have been paid in 86 years, that is, very nearly, 262 millions of debt; And, consequently, it appears, that tho' the state had been all along adding every year to its debts three millions; that is tho' in the time supposed it had contracted a debt of 258 millions, it would have been more than discharged, at no greater

expence than an annual saving of 200,000*l.* — But if the same fund had been employed in the *second* of the three ways I have described, the annuity disengaged by it would have been every year 10,000*l.*; and the sum of the annuities disengaged would have been 86 times 10,000*l.* or 860,000*l.*; — The *discharged* debt, therefore, would have been no more than the value of such an annuity, or 17,200,000*l.* But besides this, it must be considered, that there will be an expense *saved*, in consequence of applying every year the disengaged annuities to current services, for which otherwise equivalent sums must have been provided by new taxes, or assessments; 10,000*l.* will be saved at the beginning of the *second* year; 20,000*l.* at the beginning of the *third;* 30,000*l.* at the beginning of the *fourth;* and 850,000*l.* at the beginning of the 86th year; and the sum of all these savings is 36,550,000*l.* which, added to 17,200,000*l.*, the debt *discharged*, makes 53,750,000*l.* Subtract the last sum from 262 millions, and 208,250,000*l.* will be the complete loss of the public arising, in 86 years, from employing an annual sum of 200,000*l.* in the second way rather than the first.

Little need be said of the effect of the same fund applied in the *third* way. It is obvious that the whole advantage derived from it, would be the discharge of a debt of 200,000*l.* *annually;* or of 17,200,000*l.* in all.

Similar deductions might be made on the supposition of lower rates of interest and shorter periods. — Thus; let a state be supposed to run in debt two millions annually, for which it pays 4 *per cent.* interest. In 70 years, a debt of 140 millions would be incurred. But an appropriation of 400,000*l.* *per ann.*, if employed in the *first* way, would, at the end of this term, leave the nation *beforehand*, six millions; whereas, if applied in the *second* way, the nation would be left in debt, 73 millions; and in the *third* way, 112 millions.

* * * * * * *

But it is time to enter into a more explicit confutation of the plea commonly used to justify the alienation of the *Sinking Fund*, and which has been mentioned at the beginning of this Essay.

This alienation, it is well known, is become a fixed measure of Government among us. We owe it to our present heavy debt.

and if continued much longer, there will, I am afraid, be no possibility of escaping some of the worst calamities. It is, therefore, necessary that the reason on which it has been grounded, should be particularly examined and refuted. And in order to do this, I must beg leave to bring again to view some of the preceding observations.

There is, let us suppose, a million wanted for the necessary supplies of the year. It lies ready in the *Sinking Fund*, and a minister, in order to obtain leave to seize it, pleads, "That, since such a sum must be had, it is indifferent whether it is taken from hence, or procured by making a new loan. If the former is done, an *old* debt will be continued. If the latter is done, an *equal new debt* will be incurred, which would have been otherwise saved; and the public interest can be no more affected by one of these than the other. But the former is easiest. And it will save the disagreeable necessity of laying on a new tax." — This argument appears plausible: and it has never yet failed of success. — But what must prove the consequence? — If such reasoning is good one year, it is good every year; and warrants a total alienation of the *Sinking Fund*, if the annual expences of Government are such as always to require a sum equal to its income. And thus, it will lose its whole efficacy; and a Fund that, if not alienated, would have been *omnipotent*, will be converted into just such a *feeble* and *barren* one, as the *second* or *third* in the former account.

The fallaciousness of this argument consists in the supposition, that no loss can arise to the Public from continuing an *old debt*, when it cannot be discharged without incurring an *equal new debt*. — I have demonstrated this to be a mistake; and that by practising upon it, or *alienating* rather than *borrowing*, an *infinite* loss may be sustained. — Agreeably to this, I have in the Treatise on Annuities shewn, that had but 400,000*l*. *per annum* of the *Sinking Fund* been applied, from the year 1716 *inviolably*, *three millions per annum* of our taxes might now have been annihilated.

I will here add, that had the whole produce of it been thus employed, we might now have been in possession of a very considerable *surplus*, instead of being *in debt, a hundred and forty millions*. — But I will go farther. — Had even the money

that, at different times, has been employed in paying off our debts, been applied but in a different manner; that is, had it been made the produce of a *Sinking Fund*, which, from 1716 to the present year, had never been alienated; above *half* our present debts would have been cancelled. — Such is the importance of merely the *manner* of applying money. — Such is the prodigious difference, in the present case, between *borrowing* and *alienating*. — Nor is there anything in this mysterious. The reason has been sufficiently explained. — When a state borrows, it pays, I have said, only *simple* interest for money. When it alienates a Fund appropriated to the payment of its debts, it loses the advantage of money, that would have been otherwise improved necessarily at *compound* interest. And can there be any circumstances of a State which can render the latter of these preferable to the former? Or can the inconveniences, which may attend the imposition of a new tax, deserve in this case to be mentioned? What a barbarous policy is that which runs a Kingdom in debt, *Millions*, in order to save *Thousands*; which robs the Public of the power of annihilating *all* taxes in order to avoid a small present increase of taxes? — This, in truth, has been our policy; and it would be affronting common sense to attempt a vindication of it.

I confess myself incapable of speaking on this subject with calmness. — Let the Reader think of the facts I have mentioned: let him consider the difference in our favour, which an inviolable application of the *Sinking Fund* would have made: Let him compare what, in that case, we *should* have been, with what we *are*; and let him, if he can, be unmoved.

* * * * * * *

From these observations the truth of the following assertion will be very evident.

"A State may, without difficulty, redeem all its debts by borrowing money for that purpose, at an equal or even any higher interest than the debts bear; and without providing any other Funds than such small ones, as shall from year to year become necessary to pay the interest of the sums borrowed."

For Example. Suppose our Parliament, 56 years ago, had resolved to borrow half a million annually for the purpose of redeeming the debts of the kingdom. The *National Gain*, sup-

posing the money applied, without interruption, to the redemption of debts bearing 4 *per cent.* interest, would have been a *hundred millions*, being *debt redeemed*, or the sum nearly to which an annuity of half a million will accumulate in 56 years. — On the other hand. The *National Loss* would have been *twenty-eight millions*; being *debt incurred*, or the sum of all the loans. — The balance, therefore, in favour of the nation, would have been *seventy-two millions*. — During this whole period, the revenue account would have been the same that it has been, except that it would have been charged, towards paying the interest of the money borrowed, with an annuity increasing at the rate of 20,000*l.* every year. In the present year, therefore, this annuity would have been 55 times 20,000*l.*, or 1,100,000*l.* But it should be remembered, that 100 millions having been redeemed, the kingdom might have been now eased of the annual expence of *four millions*.

Again, Suppose only half a million annually to be now capable of being spared from the *Sinking Fund*. This, if applied to the redemption of the 3 *per cents.* at *par*, would pay off no more than 61 *millions* in 52 years. But let half a million be borrowed annually, for only 23 years to come; and 99 *millions* will be redeemed in the same time. That is; 38 millions more than could have been otherwise redeemed, at the extraordinary expence of only *eleven millions and a half*.

War, while such a scheme was going on, would increase its efficiency; and any suspension of it then, would be the *madness* of giving it a mortal stab, at the very time it was making the quickest progress towards the accomplishment of its end. — Suppose, for instance, that, within the period I have mentioned, two wars should happen; one to begin five years hence, and to last 10 years; the other to begin 35 years hence, and to last also 10 years, and both raising the interest of money in the *Funds* to 4½ *per cent.* It may be easily calculated, that on these suppositions 145 *millions*, instead of 99 millions, would be paid off by such a scheme. But, should it be suspended during the continuance of the two wars, it would in the same time (that is, in 52 years) pay off no more than 40 *millions*.

I know these Observations will look more like *visions* than *realities*, to those who have never turned their thoughts to these

subjects; or who have not duly attended to the amazing increase of money, bearing compound interest.—The duration of the lives of *individuals* is confined within limits so narrow, as not to admit, in any great degree, of the advantages that may be derived from this increase. But a period of 50, or 60, or 100 years being little in the duration of *kingdoms*, they are capable of securing them in almost any degree: And if no kingdoms should ever do this; if, in particular, a nation in such circumstances as ours, should continue to neglect availing itself of them: one fact will be added to the many in the political world, which tho' they cannot *surprize* a philosophical person, he must consider with concern and regret.

Money bearing compound interest increases at first slowly. But, the rate of increase being continually accelerated, it becomes in some time so rapid, as to mock all the powers of the imagination.—*One penny*, put out at our Saviour's birth to 5 *per cent. compound* interest, would, before this time, have increased to a greater sum, than would be contained in *a hundred and fifty millions of earths*, all solid gold.—But put out to *simple* interest, it would, in the same time, have amounted to no more than *seven shillings and four pence* half-penny.—Our government has hitherto chosen to improve money in the *last*, rather than the *first* of these ways.

Many schemes have at different times been proposed for paying off the National Debt. But the inventors of them might have spared their labour. Their schemes could not deserve the least notice. The best scheme has been long *known*. It has been *established;* but, unhappily for this kingdom, it was crushed in its infancy. Still, however, if our deliverance is possible, it must be derived from hence. The strictest mathematical evidence proves, that the nature of things don't admit of any method of redeeming public debts so expeditious and effectual.—*Restore, then, the Sinking Fund.* And if the *whole* of it cannot be unalienably applied to its original use, let *some part* of it be so applied; that the nation may, at least, enjoy a *chance* of being saved.—"The *Sinking Fund* (says a great writer) is the last resort of the nation; its only domestic resource, on which must chiefly depend all the hopes we can entertain of ever discharging or moderating our encumbrances. And, therefore, the

prudent application of the large sums now arising from this fund, is a point of the utmost importance, and well worthy the serious attention of Parliament." I should offer an injury to truth, were I to say no more, than that I have pointed out the most *prudent* application of this *fund*. I am persuaded that I have pointed out the *only* application of it, that can do us any essential service. Time must discover whether the *Parliament* will think it worthy of any attention.

81. A Criticism of Dr. Price, by Robert Hamilton. — In 1813 Robert Hamilton, Professor of Natural Philosophy in the University of Aberdeen, published an elaborate refutation[1] of Dr. Price's theories. Hamilton begins by laying down the following "General Principles of Finance":

I. The annual income of a nation consists of the united produce of its agriculture, manufactures, and commerce. This income is the source from which the inhabitants derive the necessaries and comforts of life; distributed, according to their stations, in various proportions; and from which the public revenue, necessary for internal administration, or for war, is raised.

II. The portion of national income which can be appropriated to public purposes, and the possible amount of taxation, is limited; and we are already far advanced to the utmost limit.

III. The amount of the revenue raised in time of peace, ought to be greater than the expense of a peace establishment, and the overplus applied to the discharge of debts contracted in former wars, or reserved as a resource for the expense of future wars.

IV. In time of war, taxes may be raised to a greater height than can be easily borne in peaceful times; and the amount of the additional taxes, together with the surplus of the peace establishment, applied for defraying the expense of the war.

V. The expense of modern wars has been generally so great, that the revenue raised within the year is insufficient to defray it. Hence the necessity of having recourse to the system of

[1] Inquiry concerning the Rise and Progress of the National Debt of Great Britain (1813). The extracts are taken from the second edition (1815).

funding, or anticipation. The sum required to complete the public expenditure is borrowed on such terms as it can be procured for; and taxes are imposed for the payment of the interest; or perhaps to a greater extent, with a view to the gradual extinction of the principal.

VI. In every year of war, where this system is adopted, the amount of the public debt is increased; and the total increase of debt during a war depends upon its duration, and the annual excess of the expenditure above the revenue.

VII. In every year of peace, the excess of the revenue above the expenditure, ought to be applied to the discharge of the national debt; and the amount discharged during any period of peace, depends upon the length of its continuance, and the amount of the annual surplus.

VIII. If the periods of war compared with those of peace, and the annual excess of the war expenditure, compared with the annual savings during the peace establishment, be so related, that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of debt; and the ultimate consequence must be, its amount to a magnitude which the nation is unable to bear.

IX. The only effectual remedies to this danger, are the extension of the relative length of the periods of peace; frugality in peace establishment; lessening the war expenses; and increase of taxes, whether permanent, or levied during the war.

X. If the three former of these remedies be impracticable, the last affords our only resource. By increasing the war taxes, the sum required to be raised by loan is lessened. By increasing the taxes in time of peace, the sum applicable to the discharge of debt is increased. These measures may be followed to such an extent, that the savings in time of peace may be brought to an equality with the surplus expenditure in time of war, even on the supposition that the periods of their relative duration shall be the same for centuries to come that they have been for a century past.

XI. When taxation is carried to the extent mentioned above, the affairs of the nation will go on, under the pressure of existing burthens, but without a continual accumulation of debt, which would terminate in bankruptcy. So long as taxation is

below that standard, accumulation of debt advances; and it becomes more difficult to raise taxation to the proper height. If it should ever be carried beyond that standard, a gradual discharge of the existing burthens will be obtained; and these consequences will take place in the exact degree in which taxation falls short of, or exceeds the standard of average expenditure.

XII. The excess of revenue above expenditure is the only real sinking fund by which the public debt can be discharged. The increase of the revenue and the diminution of expense are the only means by which this sinking fund can be enlarged, and its operations rendered more effectual: And all schemes for discharging the national debt, by sinking funds operating by compound interest, or in any other manner, unless so far as they are founded upon this principle, are illusory.

The greater part of these propositions are so incontrovertible, that it may appear superfluous to adduce any arguments in support of them, and the others may be inferred from these by a very obvious train of reasoning. Yet measures inconsistent with them have not only been advanced by men of acknowledged abilities, and expert in calculation, but have been acted on by successive administrations, and annually supported in parliament, and ostentatiously held forth in every ministerial publication. These seem to have gained possession of the public mind, and we hear them daily extolled and confided in by persons, in other respects, candid and intelligent. This not only supplies an apology for examining the principles minutely, but renders such an examination necessary.

Hamilton's twelfth proposition is supported by the following argument:

The progress and discharge of the debt of a nation are regulated by the same principles as those of an individual; and experience shows, that measures of public finance are often conducted with a degree of imprudence seldom exhibited in the management of private affairs. We may, however, extend our views to a greater length of time in regard to the former.

It is true that, upon abstract principles, the smallest sum lent

out for compound interest will, in length of time, increase to an indefinite magnitude: But it is obvious that the improvement of money in that way would be limited, at a certain amount, by the want of demand from borrowers, and the impossibility of investing it in productive capital of any kind. It is restricted within a much narrower limit by the mutability of human measures, and the actual impossibility of adherence to the same system, conducted by successive trustees through many generations. It is true that if the system were invariably adhered to, the sum would increase at the rate which calculation points out, until it was limited by the impossibility of finding borrowers, or employing it in any profitable manner.

The system of accumulating a national treasure has been long laid aside, and is not likely to be revived. We may, therefore, dispense with any further consideration of nations storing up wealth, and bestow our attention on the actual case of nations laboring under debt; sometimes endeavoring to discharge it: often obliged to increase it.

Suppose an individual has contracted a certain extent of debt, and afterward attains to circumstances which enable him to discharge it. If no oppressive and usurious measures be practiced against him by his creditors, and if he pay the interest regularly, the sum which he must pay altogether, before he be clear of debt, is the amount of money he borrowed, and the simple interest of each portion of the same, from the time of its being borrowed to the time of its repayment. Suppose he borrows £10,000, and that for 10 years he pays the interest, but no part of the principal. If the rate of interest be 5 per cent, he pays during that time £500 annually for interest, or £5000 altogether; and if, by a sudden acquisition of wealth, he is able to discharge the debt at the end of 10 years, he pays exactly £15,000 altogether. But suppose, by an amelioration of his circumstances, he is enabled to pay £1000 annually to his creditors, for principal and interest. The first year he pays £500 for interest and £500 toward the discharge of the principal. The remaining debt is £9500, and the interest of this being £475, if he can pay £1000 next year, he discharges £525 of the principal, leaving a debt of £8975. The interest of this is £448 15*s*. and next year, by paying £1000, he discharges

£551 5*s*. of the principal, and reduces the debt to £8423 15*s*. If he continue to act in this manner, the whole debt will be discharged in about 14¼ years; and the whole sum which he pays, including the £5000 paid during the first 10 years, is £19,250 nearly, being the amount of the principal, of 10 years' interest on £10,000, of 11 years' interest on £9500, of 12 years' interest on £8975, of 13 years' interest on £8243 15*s*. and so on; altogether, the principal, together with the simple interest of each portion of the same, from the time that the debt was contracted, till the time that portion was repaid. If he can only spare £750, and therefore discharge £250 of the principal the first year, it will require somewhat above 22 years to discharge the whole; and if he can only spare £600 and therefore discharge £100 of the principal the first year, it will require 37 years. In all these cases, it is the surplus of £500, of £250, or of £100, which the debtor can spare above the interest, that enables him to discharge the principal.

Instead of conducting the business in this manner, he may pay only the £500 of interest to his creditors and lend out the other £500 at interest, and lend again £500 more at the end of the next year, and so on, accumulating the sum lent by compound interest, till it amounts to £10,000, and then discharge his whole debt at once. It will require exactly the same time of 14¼ years to accomplish this. If he transact the business himself, the second way will be attended with more trouble, but the result will be the same. If he employ an agent to transact the loans, he will be a loser by following the last-mentioned methods, to the extent of the fees paid for agency.

If the debtor be able to pay no interest during the first 10 years, the creditors will either insist on accumulating the interest with the principal, in the manner of compound interest, or the debtor must borrow annually from other hands, to pay the interest annually to his original creditors, and must also borrow more each succeeding year, to pay the interest of the debts thus contracted. In either way, his debt at the end of 10 years will amount to £16,289, the interest of which being £814 9*s*. an annual payment of £1000 would discharge only £185 11*s*. of the principal debt the first year, and would require about 35 years to discharge the whole, whether he pay the

£1000 annually to his creditors to lessen the principal, after payment of the interest, or whether he accumulate the overplus by compound interest till he be able to pay the whole debt at once.

Substitute millions, or ten millions, for thousands, and the above reasoning is equally applicable to the public debt of a nation.

If the debt be ever discharged, which can only be done by a surplus revenue, and if the business be transacted as private affairs are, where the creditor is entitled to no more than the sum lent, together with the interest, the time required for the discharge of a public debt will be the same as that for a private one, when the proportion of surplus revenue is the same; and this holds whether the surplus is paid annually to the creditors, in discharge of part of the debt, so far as it will go, or accumulated in a sinking fund, in the hands of commissioners appointed for that purpose.

The whole sum paid to the public creditor, before the debt be discharged, is equal to the sum advanced by him, together with the simple interest of each portion of the same, from the time it was advanced to the time it is repaid, providing the interest be paid regularly from the time the debt is contracted. But if the payment of the interest be suspended for a certain time after the debt is contracted, then the whole sum paid is equal to the principal debt, together with the compound interest of the same, during the period of suspension, and the simple interest of each portion of this accumulated sum, from the time it is put in a train of payment, till that portion be paid.

Elsewhere Hamilton criticises Price's views more specifically, arguing, in part, as follows:

It will be proper, before proceeding, to state distinctly the points in which all agree, and the points at issue.

It is universally admitted, that every productive additional taxation tends to prevent the progress of the national debt, if it be in a state of accumulation; and to accelerate its discharge, if it be in a state of redemption.

That every increase of expenditure, whether arising from

necessity or profusion, tends to increase its accumulation, or retard its discharge.

That any sum of money, however small, improved by compound interest, will amount, in length of time, to an indefinite magnitude; and therefore,

That any surplus of national revenue above national expenditure, will be sufficient, if it continue for a long time, and be faithfully applied, to discharge any national debt, however great.

The doctrine maintained by Dr. Price is, that the formation and inviolable appropriation of a sinking fund, operating by compound interest, *in war as well as in peace*, is a measure of the utmost consequence, and that the effects of this system are greatly superior to those of any other application of a surplus, *the expenditure and taxation being equal*. . . . His work means this, or it means nothing: for it was never called in question that saving of expenditure, or increase of taxation, have a powerful effect on the state of national finance.

In opposition to Dr. Price's doctrine, it is maintained, that the separation of a sinking fund from the general revenue, is a measure of no efficacy whatever; — that the first and second methods of applying a surplus above mentioned[1] are merely different modes of official arrangement, leading to the same result; — that in time of war, when the expenditure exceeds the revenue, the preservation of the sinking fund, and consequent increase of loans, is a system from which no advantage can arise; — if it could be conducted without expense, it would be nugatory; as it is necessarily attended with expense, it is pernicious; — that at the conclusion of a war, any surplus revenue applied for the discharge of debt during the subsequent peace, operates by compound interest, during the continuance of peace. But the notion of uniting that period to another period of peace, or to a still longer period of alternate war and peace, in order to obtain the powerful effect of compound interest acting for a great length of time, is illusory.

[1] Hamilton here refers to Price's statement that there are three methods of applying a sinking fund: (1) interest released by previous payments on principal may be applied to further reduction of the debt; (2) interest thus released may be spent for current expenses; (3) or taxation may be reduced to that extent. — ED.

We return to the case supposed by Dr. Price, above mentioned,[1] and compare the effects of the first and second methods of applying the surplus, either in time of peace or war.

In time of peace, when the second method is followed, £10,000, being the interest of the debt discharged the first year, is applied to the current services of the second year; £20,000, the third year; and these sums are supposed requisite to complete what the service of each year requires; and as Dr. Price observes, they must have been borrowed, if the first method had been followed.[2] If loans be made for this purpose, either taxes must be imposed for the payment of the interest, or the sums borrowed accumulate by compound interest. In the former case, the nation is subjected to the burthen of taxes for payment of the interest of £10,000 the first year; of £20,000 more, or £30,000 altogether, the second year; and of £36,550,000 the eighty-sixth year; none of which would have been imposed according to the second method. It is this gradually increasing, and ultimately large additional taxation, that occasions the difference of £208,250,000 stated by Dr. Price, as the loss arising from the second method. If the same taxes be imposed when the second method is followed, their produce is not wanted for the services of the year, and must accumulate at the end of the period to the above-mentioned sum in favor of the public.

If taxes be not imposed to pay the interest of these loans, then to the £20,000 borrowed the second year, there must be added a sum sufficient to pay the interest of the loan of the former year; and, in like manner, a sum must be borrowed each succeeding year, equal to the interest of all the former loans, by which means the amount of these loans would accumulate by compound interest against the public.

The disengaged annuities under the second method, may be dissipated by profusion, and then there will be a difference

[1] Hamilton had devoted several pages to a presentation of Price's arguments. These pages have been omitted here, since Price's arguments to which Hamilton refers may be found in the preceding selection. — ED.

[2] Price, it will be recalled, had argued that his first method of applying a sinking fund would reduce the debt even though "the state had been all along adding every year to its debts three millions." See p. 535. — ED.

between the methods equal to what Dr. Price states; but it is the profusion, and not the mode of application, that is the cause of that difference. They may be applied to the construction of canals, harbors, and other objects of national utility; and the benefits accruing from these to the public, may repay the expense of their execution, or otherwise; but the propriety of this mode of application of surplus revenue, does not belong to our present inquiry.

In war, let us adopt Dr. Price's supposition of three millions being required annually in addition to the sums raised within the year, and of continuing the application of £200,000 as a sinking fund; which sum is comprehended in the loan of three millions. The debt contracted in three years, is nine millions; and the additional taxes for payment of interest at 5 per cent come to £450,000. The national debt redeemed by a sinking fund of £200,000, operating by compound interest in three years, is £630,500, and therefore the additional unredeemed debt is £8,369,500.

If no sinking fund be continued during the war, a loan of £2,800,000 only will be required the first year, the interest of which is £140,000. But the taxes imposed that year amount to £150,000 (for we suppose the extent of taxation in both methods equal), therefore there is a surplus of £10,000 applicable to the service of the second year. The loan required for the second year will therefore be £2,790,000; the two loans together, £5,590,000; and the interest upon them, £279,500. The additional taxes imposed the two first years amount to £300,000, leaving a surplus of £20,500 applicable to the service of the third year. The loan required the third, is therefore £2,779,500, and the amount of the three loans £8,369,500, exactly the same as the unredeemed debt when a sinking fund is continued; and it is obvious that the same equality will hold for any number of years.

When Dr. Price says that a debt of 258 millions might be discharged in eighty-six years, at no greater expense than an annual saving of £200,000, he overlooks the taxes imposed, year after year, for the payment of interest; a great part of which would not have been needed, if that annual sum had not been separated from the public revenue. The reasoning used

above is equally applicable to any other supposition of war expenditure, whatever be the annual deficiency, whether uniform or varying, — whether continued for three or thirty, or an hundred years, still the taxation and expenditure of each year being the same, the finances of the nation will be found in the same condition at the end of the period, whether the sinking fund be preserved inviolate, or entirely laid aside.

If no sinking fund be kept up for thirty years, a little alteration on the arrangement of public accounts would bring them exactly to the same state as if it had been uniformly adhered to; and conversely, the present form of our financial accounts, arising from a sinking fund, may be brought by a like alteration of arrangement, to the form in which they would have stood, if no sinking fund had ever been thought of. It is impossible that a mere change of order in the public accounts, capable of being reversed at any time, can be attended with advantage to the public.

At the termination of a war, the nation remains charged with a certain debt, and it possesses or ought to possess, a certain surplus revenue. The efficacy of this surplus to discharge the debt depends upon its proportion to the debt, and the length of time during which it is applied to that purpose, and upon these alone. It operates by compound interest. But the manner in which the debt was contracted, or the surplus obtained, have no relation to the progress and period of its discharge. It is of no avail that a sinking fund had been operating by compound interest during a former peace. When war breaks out again, the operation of compound interest is at an end. In place of continuing to discharge debt, an additional debt is contracted. When peace returns, the operation of discharge recommences from a new basis, according to the state of finance at the time. The public debt is certainly increased — the proportion of surplus revenue to that debt, and therefore the time requisite for its complete discharge, may be greater or less than at the former peace; but the two periods of peace cannot be united to obtain a powerful effect from the long continuance of compound interest.

The Doctor's plan for discharging the national debt by borrowing money at simple interest, in order to improve it at com-

pound interest, is, we apprehend, completely delusive. He admits the absurdity of such a measure in private life, — and its absurdity in national finance is exactly the same. The cases differ only in extent of sum, and duration of time, which no ways alter the general tendency of the measure. Suppose a million borrowed for this purpose, and assigned to commissioners for the redemption of the national debt, in whose hands it operates by compound interest. The interest of this loan is £50,000, which must either be provided for by some additional tax, or saved by some measure of public economy; or if neither of these be adopted, an additional loan must be made next year to pay the interest. In the former case, it is the tax or the economy, and not the operation described, that benefits the revenue; and they would have produced the same effect by affording an additional surplus improved at compound interest, without any loan. In the latter case, an additional sum of £50,000 is borrowed the second year; and a sum equal to the interest of both loans, or £102,500, the third year; and thus the debt accumulates by compound interest against the public, exactly to the same extent that the money vested in the hands of the commissioners accumulates in its favor.[1]

82. Sinking-Fund Legislation in the United States. — The early sinking-fund acts of 1792 and 1795 were constructed, in general, upon the British model. They placed certain revenues in the hands of commissioners who were to redeem United States stock, and then draw from the treasury the interest on the purchased stock and apply it to making further purchases. The act of 1802, passed in accordance with recommendations of Gallatin, enlarged and simplified the sinking fund, but did not disturb the provisions of Hamilton's sinking-fund law of 1795.

[1] A further point is brought out by Hamilton in his criticism of Pitt's sinking-fund policy, which was shaped according to the theories of Dr. Price. Hamilton shows that the money borrowed in war time in order to keep up payment on the principal of the old debt was secured on terms which really imposed a heavier rate of interest than the old debt bore. The result was that England lost heavily by borrowing at a higher rate in order to redeem a debt that bore a lower rate. He estimated the loss occasioned in this manner between 1793 and 1812 at something less than £20,000,000. *Inquiry*, pp. 149–160. — ED.

In 1817, however, the whole complicated apparatus of previous acts was swept away, and a permanent appropriation of $10,000,000 was made for the payment of interest and reduction of principal of the debt. Moreover, it was distinctly provided that, in case war should occur with any foreign power, the United States should be free to discontinue the redemption of the principal of all debts not included in the provisions of earlier sinking-fund laws.

The following account of the operation of the sinking-fund law of 1862 is presented by Professor E. A. Ross, in his monograph upon Sinking Funds:[1]

With the outbreak of the Civil War begins the final period of sinking-fund history. In the earlier part of this period we find a return to Hamiltonian principles. Secretary Chase in his report of July 4, 1861, advocated the immediate establishment of a sinking fund for the expungement of the war loans. The fruit of his policy was the clause in the act of Feb. 25, 1862.

This act, after authorizing a serious appeal to credit, undertook to establish the debt on a secure basis. The coin paid for duties on imports was to be applied, first, to the payment of interest on the bonds and notes of the United States. It was then to be applied "to the purchase or payment of one per centum of the entire debt . . . to be made within each fiscal year, which is to be set apart as a sinking fund, and the interest of which shall in like manner be applied." . . . The residue of customs receipts was to be paid into the treasury. The language of this act is plain. The provision was made part of a loan act and was to apply to future as well as to existing debt. In view of this, the words of a writer in the *Bankers' Magazine* seem warranted.

It was a formal notice to all persons, who should loan to the government, of its future intention, and constitutes a contract as binding as any can be made between it and the persons who have loaned to the government since that date.

[1] In Publications of the American Economic Association, Vol. VII (1892). Reprinted with consent of the author and the Association.

Notwithstanding the law of 1862, there was no compliance with its sinking-fund provision during the war. At the close Secretary McCulloch, who resembled Gallatin as Chase resembled Hamilton, ignored the law of 1862 and proposed a sinking fund similar to that of 1817. He estimated that a yearly appropriation to the debt of $200,000,000 would discharge the whole in about thirty years. The proposal was not accepted, and during his administration the treasury applied to the debt whatever funds were available, without reference to the sinking fund. As the actual reduction was far greater than that required by law, nobody complained.

The sinking-fund provision of 1862 seems to have been discovered by Secretary Boutwell. In his first report he announced that he had purchased twenty millions of bonds for the sinking fund. He had made further purchases, which he held as a special fund subject to the action of Congress. He recommended that such extra purchases be added to the sinking fund until it equaled what it would have been, if the law had been complied with from the first.

In the great funding act of July 14, 1870, reorganizing the public debt, it was provided that all bonds applied to the sinking fund be recorded, canceled, and destroyed, and that a sum equal to the interest on all bonds belonging to the sinking fund, be included in the yearly amortization. Heretofore the heads of the treasury had bought bonds, even beyond the requirement of the sinking fund. This action was legalized by a clause authorizing the secretary to redeem the five-twenties with any coin which he might lawfully apply to that purpose.

In 1873 the great crisis dried up the sources of revenue seriously and made it impossible to meet all claims upon the receipts. It is possible that, if Secretary Boutwell had been in office, there would have been a rigid adherence to the strict letter of the law of 1862. Under Secretary Bristow the law was practically construed to suit the emergency. It was announced that for 1874–75 there would be a surplus revenue of nine millions to be applied to the sinking fund. As under the law over thirty-one millions was required for the fund, there would be a deficiency for the year of over twenty-two millions. This was making the sinking fund the residuary legatee of the revenues.

In his report for 1875 Secretary Bristow acknowledged that the sinking-fund payment was secondary only to the interest on the public debt, and took precedence of all other appropriations. As some had asserted that the excess payments of former years excused the lapse of the sinking-fund payment when need arose, the secretary took occasion to declare that the statute imposed a duty to be performed annually, and that purchases must be made within each fiscal year. The secretary explained the cessation of bond purchases by the fact that bonds could not be bought at par, while he was forbidden by law to pay more. This deadlock, however, had been broken by the law of March 3, 1875, which authorized the secretary to obtain bonds for the sinking fund by calling in and redeeming the five-twenties.

As the deficiency in the revenues continued, the next secretary, Morrill, thought fit to present a view of the operations of the debt *in toto*. From his calculations he concluded that the public creditor had no ground for complaint.

> The terms of the law of Feb. 25, 1862, required that by the operations of the sinking-fund account, the public debt should be reduced in the sum of $433,848,215.37 between July 1, 1862, and the close of the last fiscal year. A reduction has been effected during that period of $656,992,226.44, or $223,144,011.07 more than was absolutely required.
>
> It can therefore be said, as a matter of fact, that all of the pledges and obligations of the government to make provision for the sinking fund and the cancellation of the public debt have been fully met and carried out.

The sinking fund first rose into prominence during the preparations for specie resumption. The act of 1875 permitted the sale of bonds, to procure the stock of gold necessary for resumption. A compliance with the letter of the statutes would lead to the practice of redeeming and borrowing at the same time. Sound finance required that, in such a case, the government should cease buying bonds for the sinking fund, and let the cash destined for that purpose accumulate in the treasury, awaiting the day of resumption. It was accordingly urged, and with reason, that the claims of the sinking fund should be suspended.

This was not done, but something similar was done. The

debt to which a yearly one per cent payment was pledged included notes as well as bonds. It might, therefore, be held lawful to redeem greenbacks, or even "shinplasters," for the sinking fund, in place of bonds, and thereby lessen the mass of paper to be confronted on Jan. 1, 1879. Accordingly under the law of April 17, 1876, $7,000,000 of fractional currency were credited to the sinking fund at five per cent interest. Similarly $8,000,000 of greenbacks were added under a clause in the resumption act.

Since the accession of Senator Sherman to the treasury portfolio a construction of the law of 1862 has prevailed which, however consonant with common sense and sound finance, is irreconcilable with the theory that the sinking fund then established is part of the contract with the public creditors. In his report for 1879 the secretary said: "These acts (of 1862 and 1870) are regarded as imposing upon the secretary the duty of providing for the sinking fund out of the surplus revenues of the government." The new construction was very apparent in a Senate debate, in 1884, over a proposition to reduce the sinking fund. Senator Plumb regarded the sinking fund as merely a matter of bookkeeping. . . . "The sinking fund has simply been something represented by certain entries on the books of the treasury, but nothing in the vaults of the treasury."

Senator Sherman stated that, in 1873 and thereafter, the government did not pay one fourth or one fifth of the sinking fund. In 1877 and the following years, surpluses appeared and much more was paid than the sinking fund required. The question, then, is, Has the United States, which has pledged its faith to pay a certain sum annually, a right to apply the excess payment of one year to make up the deficiency of another year? The senator regarded it as a compliance with the law when the government does substantially what it agreed to do. No man could question the faith of the United States because it was for three or four years unable from its current revenues to pay the sinking fund, provided it has, on the whole, more than made good its promise. But while the senator regarded the sinking-fund payment as justly amenable to the financial demands of the country, he deemed it inconsistent with honor and public faith to alter or invade the sinking fund by law. Temporary

exigency might suspend amortization without dishonor, but conscious policy never.

Our conclusion, then, is that the debt has been reduced, but not with the steadiness and automatic regularity contemplated by the terms of the law of 1862. Though the total reduction has exceeded the requirements of the law, yet so sensitive have the yearly appropriations been to the condition of the treasury, that it is doubtful if they could have conformed more closely to the varying financial situation, had there been no law at all.

What the secretaries have done — and they could do no more — was simply to amortize with the annual surplus, be it large or small. It is hard to see, therefore, wherein our sinking-fund law, thus administered, differs in effect from a law directing the secretary to use surplus funds to pay the debt. If Congress had ordered the law to be administered so that the sinking-fund appropriation should enjoy a priority over other appropriations, not permanent, or regular, the law would have meant something. In that case a shrinkage in the revenues would have meant a deficiency in the funds for public works, and not in the funds for the public debt. We should not then be placed in the anomalous position of granting to gratuitous appropriations like those of the river and harbor bill, the preference at the counters of the treasury over a matter of contract like the sinking-fund appropriation.

It seems, then, from our last experience, that, however solemnly a sovereign state may confer upon the principal of the public debt the first lien upon the revenues, considerations of practical policy will lead that state to relegate the principal of the debt to the frontier of public obligation, there to be abandoned, should the national income for a time retreat within narrower bounds.

CHAPTER XXIV

NATIONAL AND LOCAL DEBTS COMPARED

83. Differences in the Nature of National and Local Debts. — In addition to important legal differences, national and local debts differ in respect of the purposes for which they are contracted. This is discussed by Professor Henry C. Adams[1] as follows:

The rule according to which public functions are allotted to the various centers of power in the United States is quite simple for one who understands the political philosophy of democratic governments. The safety of democratic institutions lies in the realization of local self-government, and the principle that controls in matters of organization is that the administration of all powers should lie as closely as possible to those interested in their exercise. This theory of allotment would grant to the federal government all duties touching purely national and sovereign questions; it would press upon the local centers of administration such functions as are of peculiar local interest; while the states, standing between the two, would gather up into themselves all the remaining powers that the people have chosen to place out of their own immediate control.

From this it seems natural to expect that local financiering should differ from that of the federal government chiefly in the variety of purposes for which money is borrowed, and a glance at the history of local administration shows this expectation to have been met. The commonwealths have frequently borrowed money for purposes regarded as lying outside the appropriate duties of Congress, and, when we come to consider the course of municipal financiering since 1860, it will be seen that the activity of the minor civil divisions has also greatly extended.

[1] Public Debts, 299–306. Reprinted with the consent of the author and the publishers, Messrs. D. Appleton and Company.

The first occasion upon which the states employed their credit as a source of revenue brings to view the financial operations of the Revolutionary War. There was, at this time, much confusion, both of thought and of action, and the line of distinction between the local duties of the states and the comprehensive duties of the central government had not yet been drawn. The states had not yet surrendered any part of their sovereignty, and in consequence the administration of their treasury departments was largely shaped by national ideas. It is for this reason that the first period of local indebtedness records nothing of interest to the present comparison.[1] The states did not again come forward as borrowers of money until about 1830. The development of the railroad system, which has since revolutionized all industrial methods, had at this time just begun, and it was not then believed that private enterprise was adequate to the extensive demands of the public for highways of inland commerce. The wildest expectations were entertained respecting the efficacy of public improvements, and, under the pressure of speculative excitement thus engendered, the states were forced to undertake business enterprises upon the basis of borrowed money.

This period of excitement will receive detailed attention in the following chapter;[2] for the present is it adequate to notice that public banking and public improvements left upon the states a burden of debt from which many of them only escaped through financial disgrace. The amount of this debt in 1842, as also its character and residence, is shown by the figures in the following table:

[1] It may, however, be well to add the following details. In order to aid in the prosecution of the War for Independence, the states contracted various debts, largely, although not wholly, in the form of issues of paper money. After the war many of the states did little or nothing toward extinguishing such obligations, and were deeply in debt when the new government was formed under the Constitution. In 1790, when the federal debt was funded, Congress, upon the advice of Hamilton, decided to assume the outstanding state debts incurred for the prosecution of the war. The funding act authorized the assumption of $21,500,000 of state debts; but, after a through sifting of the indebtedness, only $18,271,000 was finally assumed. From this time onward until the period of which Professor Adams is to treat, the states made little use of their credit. — ED.

[2] Besides Professor Adams's chapter, it may be well to refer the student to a contemporary account of the financial situation of the states in 1837, by Alexander Trotter, entitled, Observations on the Financial Position of the States of the North American Union (London, 1839). — ED.

TABLE SHOWING THE AMOUNT OF DEBT RESTING UPON THE STATES IN 1842, AND THE PURPOSES FOR WHICH IT WAS INCURRED.

STATES AND TERRITORIES	PUBLIC AND INTERNAL IMPROVEMENTS	BANKING	MISCELLANEOUS	TOTAL
Maine	—	—	—	$1,734,861
Massachusetts	$4,105,000	—	$1,319,137	5,424,137
New York	21,727,267	—	70,000	21,797,267
Pennsylvania	31,186,130	—	5,149,914	36,336,044
Maryland	14,098,854	—	1,115,907	15,214,761
Virginia	6,193,161	$458,107	343,039	6,994,307
South Carolina	3,350,000	137,704	2,203,530	5,691,234
Georgia	1,309,750	—	—	1,309,750
Alabama	—	15,400,000	—	15,400,000
Louisiana	1,200,000	20,200,000	2,585,000	23,985,500
Mississippi	—	7,000,000	—	7,000,000
Arkansas	—	2,676,000	—	2,676,000
Kentucky	3,085,000	—	—	3,085,000
Tennessee	1,198,166	2,000,000	—	3,198,166
Michigan	5,420,000	—	191,000	5,611,000
Ohio	10,924,123	—	—	10,924,123
Indiana	11,751,000	1,000,000	—	12,751,000
Illinois	10,371,294	3,034,998	121,000	13,527,292
Missouri	20,000	389,261	433,000	842,261
Territory of Florida	—	3,900,000	100,000	4,000,000
District of Columbia	—	—	—	1,316,030

From the facts which this table displays, it appears that the cotton and tobacco-growing states expressed a decided preference for public banking, while the grain and metal-bearing states favored the building of canals and railroads. One may not, however, on this account, conclude that public sentiment in the North respecting banking questions was more highly educated than in the South, for the fact is that during this period the people of the North were provided with all the paper money they could desire. The Southern states did not so strongly feel the need of railroads and canals, for the nature of their produce, and the character of their industrial society, did not suggest the necessity of rapid inland communication. They regarded it as much more desirable to furnish the planter with "capital" for

the adoption of better methods in the culture of cotton, and to this end they established banks, or guaranteed the payment of notes issued by private associations. On the other hand, the great majority of the Northern states seem to have been completely mastered by the enthusiasm for public improvements. New York led the way by building the Erie Canal, and Pennsylvania and Maryland quickly followed, in order to protect their local interests. The lake states also, desiring to avail themselves of the benefits arising from direct communication with the Atlantic seaboard, and to open all parts of their territory to rapid settlement, adopted a similar policy. Other states, as, for example, Kentucky and Tennessee, having no need for either cotton-banks or canals, but being influenced by the general enthusiasm for public improvements, set about building turnpikes and toll roads.

It appears, then, that the debts contracted by the states between 1830 and 1850 differ somewhat from those considered in the former part of this essay. Not only were the bonds issued for a different purpose, but it was supposed that they would rest for their extinction upon a different fund; and from this it must follow that the rules appropriate to the management of the federal treasury do not apply in all strictness to local financiering.

Since 1850, the history of the treasury operations of the states presents little of importance to the student of finance. The amount of their indebtedness, less sinking-fund accumulations, was, in 1880, as follows:

Eastern states	$35,207,482
Middle states	37,575,110
Southern states	123,803,235
Western states	37,671,256
Pacific states	179,178

Taking into consideration what we know of the relative wealth of the sections here represented, it appears that the only considerable sum of debt lies upon the Southern states, nor is this so large but that the entire amount might be wiped out by a moderate taxing-policy vigorously applied. This debt was created for the most part during a period of bad government.

The general fact with regard to the states seems to be that, at the present time, they possess no financial standing. They never appear upon the market as borrowers of large amounts of capital, for their administrative activity has been so restricted as to render this unnecessary.[1] Duties which they once performed have passed either to the federal government, as in the case of banking, or to private corporations, as in the case of railroads. The questions of organization and administration suggested by this state of affairs are certainly of importance, and all that follows bearing upon the history of local indebtedness may be regarded as leading to their solution.

If now our attention be turned to the cities and minor civil divisions, the same necessity for special and detailed study will present itself. The purposes for which municipalities have employed their public credit are peculiar to the position which they hold in the general structure of government, and the rules by which their treasuries should be managed are shaped by the peculiar duties imposed. The totals of local indebtedness for certain significant years are given in the table below. The states, which began to assume obligations in 1830, found themselves most heavily burdened, wealth and population being taken into the account, in 1842; but at this date the cities were comparatively free from debt, while the minor civil divisions had not yet made such use of their public credit as to attract general attention. For the year 1880, the amounts presented in the tables are net indebtedness; for the previous dates no such careful estimate has been made to secure accuracy of statement. It is further necessary to notice that for the years 1870 and 1880 the debt of townships and school districts is included under the heading of city obligations.

[1] The unfortunate experiences of certain commonwealths between 1830 and 1840 led to the incorporation into state constitutions of many provisions designed to check the further growth of state debts. Some constitutions prohibit the state governments from entering upon schemes for internal improvements. Others, and these are the most numerous class, prohibit the states from incurring debts beyond certain small amounts, which range from $50,000, the minimum, to $1,000,000, as a maximum. Very frequently, also, the constitutions provide that every debt contracted shall be accompanied by the levy of a tax sufficient to sink it within a somewhat short period, as from five to ten years. See the Reports upon Public Debt, of the Tenth and Eleventh Censuses. These constitutional limitations date back to the period following 1840; they are found in the more recent state constitutions also. — Ed.

TABLE SHOWING THE RELATIVE GROWTH OF STATE AND MUNICIPAL DEBTS [1]

	1842	1870	1880
State debts	$198,800,000	$352,800,000	$234,430,000
City debts	27,500,000	328,250,000	698,270,000
County debts	—	187,500,000	123,870,000

The important feature of this table is the change in the balance of indebtedness which its figures portray. While the states have in large measure retired from the market as borrowers of money, the municipalities have increased the frequency and extent of their demands. It is true that the total per capita debt of both together was not as large in 1880 as in 1870, being $23 in the earlier period, and $21 in the latter, but the proportion of this sum for which the cities are responsible is greatly increased.

But for what purposes did the municipal corporations incur their obligations? For an answer to this inquiry we are obliged to rely upon data furnished by the Census Report of 1880. The facts desired are not there given, but it is possible to arrive at substantially accurate results by means of a simple calculation from the figures furnished. The figures, upon which this calculation proceeds, as well as the results derived, are presented in the following table:

[1] For 1890, the last year for which data are available at the time of writing, the state and local debts were as follows:

State debts	$228,997,000
County debts	145,048,000
Municipal debts	724,463,000
School-district debts	36,701,000

Great differences appear in the per capita state and local indebtedness of different parts of the country. In West Virginia, in 1890, the per capita indebtedness was but $3.32; in Maryland it was $40.46. In general, the per capita debts were smallest in the South and West. Heaviest of all was the per capita debt of the District of Columbia, which was not less than $85.86. Nearly half of the states and territories had state and local debts amounting to more than $20 per capita. — ED.

TABLE SHOWING AMOUNT OF BONDED DEBT IN 1880, FOR STATES, CITIES, AND MINOR CIVIL DIVISIONS AND PURPOSES FOR WHICH BONDS WERE ISSUED.

Purpose for which Local Debts were Contracted	State and Local Indebtedness, as given in the Census of 1880	Indebtedness of Cities with Population of 7500 and upward, as given in Census of 1880	Indebtedness of States as computed from Balance Sheets of States	Indebtedness of Towns and Minor Civil Divisions, computed from the Foregoing
Bridges	$24,853,388	$20,809,431	—	$4,043,957
Cemeteries	283,816	272,912	—	10,904
Fire department	2,514,082	2,214,924	—	299,158
Public parks	40,612,536	40,490,636	—	121,900
Sewerage	21,370,536	21,335,434	—	35,102
Streets	86,674,860	81,502,817	—	5,172,043
Waterworks	146,423,565	141,797,828	—	4,625,737
Bounties, militia, war	75,154,400	28,722,787	$33,310,738	13,120,875
Funding of floating debts	153,949,095	122,864,804	2,978,048	28,106,243
Refunding old debt	138,743,730	71,071,140	57,057,862	10,614,728
Public buildings	48,493,952	25,516,829	6,327,780	16,649,343
Railroads	185,638,948	68,309,493	47,984,090	69,345,365
Canals, rivers, water power	36,224,548	16,726,064	8,655,780	10,842,704
Schools and libraries	26,509,457	13,889,915	—	12,619,542
Miscellaneous	130,374,758	26,571,446	90,000,000	13,803,312
Total	$1,117,821,671	$682,096,460	$246,314,298	$189,410,913

There are many significant items in the foregoing table. For example, the assistance granted to railroads suggests a line of study that demands a comprehensive investigation of the entire subject of internal improvements in the United States. Another point of interest is the excessive use made by municipalities of floating obligations. Cities have no business to create floating debts, and yet over $150,000,000 of their obligations are traceable to this source. Or, reverting again to the question of the balance of indebtedness, the foregoing table shows that the employment of credit by the larger cities is greatly in excess of its use by the minor civil divisions. There are in the United

States some three hundred first-class cities, containing about one fourth of the total population of the country; but their indebtedness is $682,000,000 as against $189,000,000 borne by the other municipal corporations. These are indeed startling figures and, when understood, disclose certain dangerous tendencies in the development of local administration; but since it is the purpose of the remainder of this treatise to interpret the facts thus disclosed, we need not dwell longer upon them at the present time.

84. Differences in the Principles of Financiering Applicable to National and to Local Debts. — Professor Adams continues:[1]

It remains to inquire how far the general principles of national financiering may be followed in the administration of local affairs. It is quite clear that these principles must be subject to some modification, for rules of deficit financiering spring in large measure from the conditions under which debts are contracted, and these conditions are shaped by the purposes for which appeal is had to credit. From a survey of the items mentioned in the foregoing table, it seems that the debts resting upon the cities and minor civil divisions are capable of a threefold classification. In the first class are included those debts incurred for the purpose of rendering a direct though a general service to the public. The building of highways; the maintenance of a fire department; the construction of sewers, and the like, are examples of such services. The second class includes those debts incurred for the purpose of rendering a direct service to the public, but of a particular rather than a general character. This division comprises such services as the supply of water, or gas, or heat, to the citizens of a municipal corporation. The purchase of cemetery grounds for resale to individuals would also be included in this class. The third kind of local indebtedness arises when the governing body employs its credit for granting assistance to private corporations, believing thereby to serve the public indirectly through the industries established.

All of these classes of debts have certain characteristics in

[1] Public Debts, 306–316.

common which distinguish them from debts contracted for national purposes. One important point of contrast pertains to the nature of the demands for which money is borrowed. When the federal government appears upon the market, the demand for increased revenue is usually sudden and extensive, and of such a sort that no safe estimate can be made of the amount needed. This is not true in the case of the minor civil divisions. Local financiering is entered upon with foresight, and not under the stress of any emergency. It follows from this that common business maxims may be more closely observed, and general political and industrial considerations less strenuously regarded. A local council partakes more nearly of the character of the governing board of a corporation than is the case with the cabinet of the federal government. For similar reasons, also, the defense of local debts is different from that of national debts. A city or a town cannot possibly urge the plea of imperative necessity. It is true that some great disaster, as fire or flood, may incline the local authorities to render immediate assistance to those citizens who are subjects of misfortune. But this desire cannot be reflected in the record of indebtedness, since bonds issued for such purposes would be held invalid by the courts. The only defense of local borrowing rests upon the common-sense principle of payment by installments. A revenue law that makes sudden and rapid changes in the rates of taxation is the occasion of unnecessary inconvenience and vexation, and, notwithstanding the rise of extraordinary demands, the evils attending such arbitrary changes may be easily avoided by a resort to credit. If, for example, a courthouse or a city hall is to be erected, it is of common advantage that the people who are called upon to foot the bills should be permitted to distribute their contributions over several years.

A further distinction is suggested when it is noticed that the national financier is forbidden to calculate upon any income that may arise from the manner in which the proceeds of a loan may be expended, and that he is in consequence obliged to rely upon taxes for the support of the debt.[1] But in contrast with this, it frequently occurs that local authorities under-

[1] The query may arise if bonds issued for territorial purchases do not form an exception to this statement. Why may not land bonds be provided for out of the

take productive industries and derive a steady income from the investment of moneys borrowed. Thus, the proceeds of a loan are said to be spent for remunerative purposes when invested in such a manner as to render direct personal service to citizens. The furnishing of gas, or of water, or of heat, are illustrations of such services. In cases of this sort, the burden of debt is thrown upon the public industry which its proceeds establish, and its support and final payment are assumed to rest with those who are benefited by the service in proportion to the benefit received. For example, it is the common practice for waterworks to be supported by water rates; and it conforms fully to the requirements of finance that these rates should be so adjusted as to pay for the plant independently of taxation, except so far as the city is itself a consumer. Such a method of treasury management, which leads to the assignment of specific funds to specific services, is not common in national financiering. But in local affairs, the principle thus disclosed is one of wide application, and modifies in a marked degree the general rules for the administration of local debts.

Passing, however, from such general distinctions, one may easily observe certain technical differences in the administration of a local and a national debt, arising from the varying conditions under which credit is employed. The most important of these pertain to the use of sinking funds, tax loans, and floating

proceeds of the sale of land? This might be possible under some circumstances. If the land were already under cultivation, or if the government should purchase it with a view of going into the business of forestry, it might be desirable to pay the debt created out of the proceeds of the property; but according to the land policy adopted in the United States, the financier is forbidden such calculations. Indeed, a loan for the purpose of purchasing large tracts of wild, uncultivated land must primarily rest upon taxes, because such lands can only be sold as they are gradually absorbed by advancing population. The treasury figures show this to have been true in the case of the Louisiana Purchase. The total amount of six per cent stock which it was found necessary to create for payment to France was $11,250,000 (Bayley's National Loans, p. 120). This stock was issued in 1804. Payment upon it was begun in 1812, and, with the exception of about $8000, the entire debt was expunged in 1821. If now a date as late as 1825 be taken, it appears that the total gross revenue from sales of lands lying within the French cession was but $2,286,220 (Johnson's Report on the Relief of the States, p. 324). There seems to have been no difference, then, so far as taxes are concerned, between this financial operation and the borrowing of money for purposes of war.

debts, as well as to those measures which make provision for the future conversion of public funds. Those rules peculiar to local financiering thus suggested are as follows. The administrator of local finances is permitted to found a sinking fund at the time of issuing bonds, a permission, it will be remembered, contrary to sound rules of national financiering. The same may be said of the employment of tax loans, although the reasons against the use of such obligations by a federal financier are not so strong as in the case of sinking funds. Temporary debts, on the other hand, are regarded as necessary for governments imposed with the duty of carrying through a war, or of meeting sudden fiscal emergencies; but in local affairs there is nothing which testifies so unmistakably to fiscal incapacity as the existence of large floating debts. And, lastly, the thought of an ultimate conversion of the funds, which may properly influence the drawing of a federal contract, can modify but slightly the form of municipal bonds.

All these rules spring from the fact that the purposes for which local governments may properly contract debts do not demand obligations running for a long series of years. It is of even greater importance for the municipal than for the national administrators to remember that public credit is simply a means for anticipating clear revenue. The principles of perpetual indebtedness may properly give direction to a federal policy, because the extent of extraordinary federal demands is frequently uncertain, and the time of their occurrence is altogether beyond the control of the government; but in local concerns, the occasion for the resort to public credit is wholly a matter of choice, and reliance may be had upon calculations of expenditure and upon estimates of income. It is this fact that modifies the general rules of finance when credit is employed by the officials of minor civil divisions. Let us consider this more closely.

The attachment of a sinking fund, for example, to a loan bill, when the proceeds of the loan are to be expended for war purposes, is useless, to say the least, because the extent of the demand cannot, from the nature of the case, be known. Such a procedure involves the absurdity of borrowing money with which to pay an old debt, while yet under the necessity of employing credit to meet new expenditure. But in local affairs,

early provision for the payment of a debt is evidence of sound business principles. All the facts bearing upon the question are known to the authorities when they determine to borrow money, and there is consequently no reason why they should not make adequate provision for expunging a debt at the time it is created. This may be the more readily recognized if we call to mind the three conflicting interests which may be harmonized by the employment of local credit.

The first of these is the engineering interest, which demands that public works once begun should be carried on as rapidly as possible to their completion, and this can only be done by assured control over a large sum of money. The second is the financial interest, which regards it as essential that tax rates should not be subject to sudden fluctuations. The third is what may be called the general social interest, which stands opposed to the perpetuation of local debts. So far as the first two of these interests are concerned, the attachment of a sinking-fund clause to a debt contract is of no particular importance; but since quick and certain payment is demanded by considerations of general welfare, and since neither the engineer nor the tax assessor can object to an early provision for payment, such provision must be accepted as an essential requirement for the management of a local debt. The same line of argument might be used with regard to tax loans, a form of credit that cannot be employed in any marked degree when the extent of extraordinary demands may not be estimated with safety. Indeed, there is no difference in principle between a tax loan and a loan with a sinking-fund attachment.

There is also an additional reason why a law authorizing the issue of local bonds should contain a provision for the establishment of a sinking fund. It will be remembered that cities and minor civil divisions are inferior and dependent governments, and that their officers are subject to the jurisdiction of the courts to the extent that laws which exist must be executed. If now a sinking fund be created by the law that creates the debt, a public creditor has an assured and an easy method of securing payment upon valid obligations. It does not follow that the creditor would always enforce his rights should the sinking-fund payments be passed, but the fact that it lies within his power to

do so gives an additional value to the obligations, and consequently an additional advantage to the municipality in the placement of its bonds. This consideration does not apply to the federal government, nor at the present time to the state governments, because they are both sovereign for debt purposes, and the only security which it is possible for their bonds to offer is the good will of their legislative bodies.

The general evils attending an excessive use of floating obligations have been already pointed out, and it is only necessary to add, in this connection, that the alternatives which sometimes demand their employment by the national financier can never arise for local administrators. The only defense of a floating debt is the fact that an administration is surprised with sudden demands which cannot await the sale of ordinary obligations; but such a surprise cannot present itself to the local financier, who himself determines the occasion and extent of fiscal demands. As has been frequently remarked, local financiers have nothing to do with emergencies. Still, one cannot conclude from this that city and county warrants, certificates of indebtedness, and such temporary paper, should never be employed. Such instruments of credit may or may not constitute a floating debt, according as they are or are not assigned to some assured revenue. If a definite amount of clear income be appropriated to their payment, common warrants are properly classed as tax loans and not as floating debts, and their convenience in treasury administration commends their use. That which is here condemned is that looseness, so frequently to be observed in the management of city accounts, which leads to the settlement of claims by the issue of warrants and certificates. The funding of such paper must come sooner or later, and the city that thus postpones the liquidation of its accounts is sure to become embarrassed.

It follows, likewise, from the reasons already given, that the policy of local indebtedness need not be shaped with a view to ultimate conversion. Conversion of a public debt means such a modification of the contract as to secure, before its final payment, more favorable terms than those originally entered into. In the case of national financiering this is of great importance, because the conditions under which money is borrowed are com-

monly such that the government is obliged to accede to severe terms. A state of war, for example, is unfortunate for the borrowing of money, and without any change whatever in the industrial relations, the return of peace will give a government control over capital at cheaper rates than it was obliged to pay during the continuance of hostilities. But this cannot apply to local financiering, for a local government is at liberty to select the most opportune times for the sale of its bonds, and consequently it need never suffer the expense of high rates of interest to overcome the risk of investment. So far as the rate of interest is dependent upon risk, a municipal council may censure itself if that rate be not as low when a debt is created as after several years shall have elapsed.

Again, in the administration of national affairs, it may be necessary to contract a debt of such magnitude that it cannot be expunged before the natural development of commercial relations shall have reduced the rate for which money may be secured; and from this it follows that the thought of ultimate conversion should be always kept prominently in view. But this reasoning cannot apply to local borrowing, for local debts should never cover periods so extended that industrial changes can materially modify the value of money while specific obligations continue to run. The purposes for which municipalities borrow do not require that their obligations should long remain in the hands of creditors. It may be that those conditions justifying an appeal to credit will constantly recur in the course of local administration, so that the local government will not be freed from debt for a long series of years; but it will be a debt constantly in course of expungement, and in this manner whatever advantage arises from a gradual fall in the rate of interest can be secured to municipalities. In local financiering, new borrowing secures money for new purposes, while existing taxes expunge old debts; in national financiering, conversion implies the employment of fresh credit in order to pay off existing debt for the purpose of obtaining better terms — but in either case the governing bodies reap an advantage from constantly falling interest.

The accuracy of what has been said may, perhaps, be more clearly discerned in the reflected light of another distinction.

Those considerations that determine the time at which the payment of debts should begin, as also the rate at which it should proceed, are quite different for national and local financiering. The point at which the two policies diverge is, that in the one case money is borrowed for general and in the other for particular purposes. When a debt is contracted for a general purpose, as is the case in time of war, it is conceived to rest upon the combined industries of the country, and questions pertaining to payment are determined by the state of trade. This subject has been already discussed in a foregoing chapter. Most local debts, on the other hand, are contracted for some definite purpose, and their proceeds are employed in such a manner as to establish in the community some particular form of public service; it is natural, therefore, that the expungement of a local debt should conform to the manner in which its funds were invested. As an illustration, suppose capital to be borrowed for the purpose of paving streets or providing sewerage, the service thus rendered is common to all members of the community, but of such a nature that the debt must rest upon taxes. But what is of yet more importance, the local council cannot proceed as though the city would never be called upon to repeat its expenditure, for pavements and sewerage are subject to wear, and must sooner or later be replaced by new systems. From this it must appear that the payment of a local debt is not to be determined by the general industrial conditions of the country, but that sound policy demands the expungement of existing obligations before the public authorities find it necessary to borrow fresh capital for new improvements. It seems, then, that the rapidity with which such payments should be made depends upon the probable life of the pavement or the sewerage, and this is a question that must be determined by the city engineer.

Similar reasoning applies, only in a more marked degree, if the proceeds of a debt are employed to establish remunerative public works, for in such a case the income from the public industry established is supposed to support the debt. With regard to gasworks and waterworks, for example, general business rules may be appropriately applied for the reimbursement of capital sunk. Such debts should be paid as

rapidly as the interests of consumers will bear, so that the property may become an unincumbered property to the community. There are other conditions, however, in which these rules of payment may be somewhat modified. In the case of purchasing real estate for public parks, or of lending assistance to railroads or other private enterprises, the policy that should direct a local treasury is more nearly akin to that followed by the national financier. The reason is that these measures are conceived to be exceptional rather than constantly recurring. The real estate of a park, which at first may cost a large sum of money, is an investment the value of which is not depreciated by time and use; the benefits supposed to arise from large commercial facilities are also of a permanent nature. It follows that the payment of such debts may properly extend over a longer period, and for two reasons. The fact that the investment is permanent obviates the necessity of clearing accounts before a similar expenditure of fresh money is required. But of more importance is the demand that the rate of taxation shall not be changed with unnecessary rapidity. If, for example, it were undertaken to pay for a park purchased in four or five years, there would be an unnecessary burden entailed upon the community, first, by the rapid rise in tax rates, and second, by the rapid fall in tax rates after the payment had been accomplished. It is true that this is not of so much importance in local taxation, where impositions are for the most part direct, as in the case of federal taxes, where reliance is had upon indirect contributions; but it yet applies, and from it one may conclude that a two or three per cent sinking fund provides for the extinction of such debts with sufficient rapidity.

CHAPTER XXV

FINANCIAL LEGISLATION IN THE UNITED STATES

85. Congressional Legislation. — The methods by which Congress enacts revenue and appropriation laws are thus characterized by a recent critic: [1]

The headless condition of American public finance has long been the remark of astonished foreign observers, and the concern even of some of those who live under it and suffer from it. Always defective in theory, in practice the American system of control over the national income and outgo has become, with time, more and more confused and uncertain, and has led to results more and more grotesque or alarming. With one set of men guessing at what the national revenue will be under the taxes imposed by them; with several other sets hazarding conflicting estimates of the national expenditure, according to appropriations made by them; with the courts continually stepping in to declare taxes null and void, or to direct their incidence in ways different from the intention of those who framed them; with appropriations "held up" in the discretion of the secretary of the treasury or vetoed by the comptroller, it is no wonder that the shrewdest forecasts of the treasury are often made ludicrous by the event, or that the whole system should sometimes seem a melancholy jumble.

True, the argument of pike and gun has long been available to those who maintain that it is the best possible system in the best of possible governments. Whatever you might say, just look at the results, look at the income leaping up to surpass the increasing expenses, look at the regularly recurring surplus. How can a system be bad which leads to such prosperity? The true question was all the while, of course, whether it was the

[1] R. Ogden, The Rationale of Congressional Extravagance, in *Yale Review*, VI, 37–49 (1897). Reprinted with consent of the author and the *Yale Review*.

system that led to the prosperity, or the prosperity that obscured the vices of the system. But there is no need of going back over all this now. The patient at last admits that he is ill. Even a nation long accustomed to take no note of its symptoms, to heed no warnings, has to acknowledge that something is wrong after the first session of the Fifty-fourth Congress.

It opened with a notice served by the most absolute speaker in congressional history, that the severest economy would have to be practiced. Before a month had passed, the Committee on Ways and Means reported that the national revenues were grievously deficient, and proposed taxes which, in its opinion, would increase them. All through the session retrenchment and rigid economy were the cries of party press and party leaders. The chairman of the Committee on Appropriations was outspoken in his purpose of using the knife unsparingly. There was to be no river-and-harbor bill at all. Not a new public building was to be voted, not a new ship, not an unnecessary paper cutter. The leaders seemed to be, and doubtless were, sincere and determined in all this, and the session slipped away with Congress complacently feeling that it was very virtuous and economical. It was with something like a rueful gasp, then, that it faced the facts at the close of the session. Not a bill to increase the declining revenue had become law, but bills appropriating much more than the revenue had passed in shoals. A swollen river-and-harbor bill went through Congress and over the President's veto with the ease of fate. This frugal and patriotic Congress, meeting in a time of great financial embarrassment, private and public, stood in a sort of mute and shamefaced astonishment, confronting a total of $515,000,000 of the people's money voted away by it — a sum equal to the annual appropriations when a gigantic civil war was in progress, and a million men had to be supported under arms.

That the increase of appropriations has been a continuous phenomenon is shown by Secretary Carlisle in his last annual report, in a passage which is too pat to the purpose of this article to be left unquoted :

The great increase in the ordinary expenditures of the government during the last seven years has been without precedent in our history, in time of peace, and presents a subject which imperatively demands the most serious consider-

ation of Congress. In 1870, for the first time after the close of the war, our public expenditures, excluding premiums on loans and purchases of bonds, but including interest and pensions, fell below the sum of $300,000,000, and they continued to decrease, with some fluctuations, until 1886, when they reached their lowest point, amounting to $242,483,138.50. During the four fiscal years, beginning July 1, 1885, and ending June 30, 1889, the annual average of expenditure, excluding premiums on loans and purchases of bonds, but including all the other items mentioned above, was $263,016,473.18, but during the next four fiscal years, beginning July 1, 1889, and ending June 30, 1893, the annual average was $345,405,163.60, an increase of $82,338,690.42 for each year. The average annual ordinary expenditures of the government during the three fiscal years beginning July 1, 1893, and ending June 30, 1896, were $358,633,341.40, an annual increase of $13,228,177.80, over the next preceding four years. The ordinary receipts of the government during the last fiscal year — $326,976,200.38 — would have paid the average annual expenditures during the four years from July 1, 1885, to June 30, 1889, and left a surplus of $63,959,727.20 at the end of each year, or $255,838,980 at the close of the period. The expenditures for the year 1896, although $31,298,508.41 less than in 1893, were nearly 25 per cent higher than in 1889. For the current fiscal year the ordinary expenditures, excluding the cost of the postal service, except the deficiency, will, according to the estimates, reach the sum of $382,500,000, an amount which has been equaled in only one year since 1866.

What has led to this strange impairment of the power of the purse? Why has Congress, inheritor of the right wrested from the king to control national expenditure, become seemingly unable to control it, not as against king or President, but as against itself?

The answer is to be found, in part at least and proximately, in the breaking down of the rules and devices which have heretofore been measurably effective in preventing Congress from having its own way in money matters. A check of some kind has to be sharply enforced upon every representative assembly, in respect to spending money, or the bottom of the public purse and credit will be quickly in sight. In the House of Commons, as everybody knows, a private member cannot so much as introduce a bill making an appropriation of money; all money bills are absolutely within the control of the cabinet. But we have given, or have imagined that we have given, unfettered freedom to Congress. Any member can propose a law carrying an appropriation, and can pass it if he can get the assent of a majority. Nothing of the kind. This has been one of our

pleasing little fictions. We have had our hook in the jaw of Congress — not as strong and well-secured a hook as the one the chancellor of the exchequer wields — but still a hook which, on the whole, and till lately, has held, and kept leviathan in grumbling subjection. Look at the mass of money bills that perish in every Congress. Ask the puzzled and angry representatives who go home baffled, their pet bills never having come in sight of passage. They will tell you of a complicated set of ingeniously devised rules and practices which keep their hands out of the public treasury. Every Congress would be extravagant if the rules and customs would let it. The rationale of the recent increase in congressional extravagance lies in the crumbling away of the barriers which have hitherto stood between the public money and those who want to vote it away.

1. What are known as permanent and indefinite appropriations withdraw large amounts of money paid out by the nation from even the nominal consideration of Congress. They are provided for by statutes which run without limit of date, and cover such indeterminate charges as interest on the public debt and payments into the sinking fund, with such specific charges as the maintenance of the militia service and the cost of collecting the revenue, together with many minor and miscellaneous payments. A committee of the Fifty-second Congress examined the whole subject, and discovered no less than 185 separate statutes taking money from the treasury in the form of permanent appropriations. The total sums called for by them all, Congress is expected to vote, and does vote, simply on the statement of the secretary of the treasury as to what existing laws call for, and without scrutiny or scruple. In the committee's report it is said: "It will be observed that the tendency to increase the number of permanent appropriations is of decided growth in comparatively recent times. . . . Stability for certain payments is sought by this means, but it takes from the country and from Congress the habit of voluntarily providing yearly for those obligations which most strongly appeal to the debt-paying sentiment. In the great increase of public business, Congress seems to vibrate between a disposition to retain full scrutiny of the public business and a desire to escape some of the annual labor involved."

Superficially, the official figures do not bear out the committee's assertion that there has been a growth in permanent appropriations. In 1881, they called for $141,000,000, out of a total estimated expenditure of $278,000,000. In 1887, the figures were $118,000,000 and $339,000,000, respectively; in 1891, $52,000,000 and $292,000,000; for 1897, according to the estimates laid before Congress by Secretary Carlisle, they should be $69,000,000 and $457,000,000. But the interest on the public debt and payments into the sinking fund account for the large figures of ten and fifteen years ago. Even in 1887, $94,000,000 of the total permanent appropriations of $118,000,000 went in those items; $33,000,000 will so go in 1897. It is in the item "miscellaneous" that we see the real growth of the system and the abuse of it. In 1881, Congress was asked to vote in the dark but $1,766,000 in miscellaneous permanent appropriations. In 1885, the sum had grown to $4,583,000; in 1891, to $5,075,000; in 1897 it will be not short of $21,769,000. This clearly marks the tendency to move greater and greater sums from the need of running the yearly gantlet. In one notorious case, a senator actually twitted his political opponents with their inability, even in a future Congress, to repeal an obnoxious appropriation, inasmuch as he and his colleagues were going to improve their day of power by fastening it on the country in the shape of a permanent appropriation.

The subject is one which has frequently caught the attention of the more watchful congressmen. A bill was introduced by Mr. Sayers in the Fifty-second Congress to repeal many of the statutes appropriating money in this fashion. Similar bills were brought in in other Congresses by Mr. Dockery, Mr. Beck, Mr. Cannon, Mr. Garfield, and Mr. Randall. Secretary Sherman in 1877 admitted the need of changes in the laws, and Secretary Carlisle in 1894 expressed himself in favor of "restricting the principle" within certain well-defined limits. Without entering into the merits of the question, considered from the point of view of those having just claims against the treasury, or of accounting officers, it is clear that the practice of voting larger and larger lump sums, simply in execution of statutes by foregoing Congresses, tends to do away with that jealous examination and debate of money bills which has been one of the chief

characteristics of a popular legislature having the power of the purse. The reduction of the system to the absurd was seen at the close of the first session of the Fifty-fourth Congress, when Mr. Cannon, chairman of the Committee on Appropriations, stood up and coolly deducted the amount of the permanent appropriations from the total voted. For those he disclaimed personal or party responsibility. Fate or Providence must shoulder that burden. Evidently it needs only the extension of the system to make party or congressional responsibility for appropriations disappear altogether.

2. A second factor in the increasing helplessness of Congress in the matter of expenditure is the steady breaking down of centralized and responsible control over appropriations. Originally, appropriations were, as they should be, harnessed to taxation. Down to 1865, when a standing committee on appropriations was first appointed in Congress, the Committee on Ways and Means, the taxing committee, was also the appropriating committee. In early congressional legislation, appropriations for the several branches of the public service were made in a single act. Now they are broken up into thirteen annual appropriation bills, though of the thirteen the Committee on Appropriations has charge of only six. Little by little the others have been taken from it, with the undoubted result of dissipating both responsibility and revenue. The tendency to continue the process is marked, and to give to every committee the power to report appropriations connected with its own subjects. What has been done in the House to scatter responsibility and resources it is now proposed to do in the Senate also. A strong movement in that body to break up the appropriation bills, and to disintegrate the central authority which now presides over the annual expenditures, so far as the Senate is concerned, was only narrowly defeated a year ago. Next time it will succeed. The ostensible reason urged for the change is the greater care and time which the separate committees can bestow upon the separate bills. The real reason is to magnify the importance of the smaller men and the smaller committees. The certain result will be to destroy responsibility and swell the appropriations.

As early as the Forty-third Congress — that is, within less

than ten years of the creation of the Committee on Appropriations — complaint was loudly made that its powers were too great and autocratic. But when the Democrats came into control of the Forty-fourth Congress, stringently pledged to retrenchment, one of the first steps they took was to increase the power of the Committee on Appropriations. They saw where they must strike if there was to be any cutting down at all. On Jan. 17, 1876, an amendment to the rules was introduced and passed which, in the language of one opposing the change, would "practically abolish all committees except the Committee on Appropriations." Mr. Randall frankly admitted that his intention was to consolidate control of expenditures in the Committee on Appropriations and so secure retrenchment. He himself was able to set forth the result on Feb. 8, 1877, when he said: "The appropriations of the last Congress amounted in the aggregate to $359,066,668. On the other hand, the appropriations of the Forty-fourth Congress, according to your own books, made up by the Departments, were during the first session $148,451,573, and the probability is that if the Senate does not resist the appropriations recommended by the Committee on Appropriations, so far as I am able to gather what they will be this session, they will be $142,286,597; making the appropriation bills of the present Congress during its two sessions for the two years aggregate $290,738,171. And the net result of the presence here of a Democratic House is thus shown to be a saving to the people of $68,328,497."

It is not necessary to take up the disputed question whether these reductions were wise or not. The critical fact is that they were made, and that it was the concentrated and effective power of the Committee on Appropriations that allowed them to be made. With one great bill after another taken away from the purview and control of that committee, it is not strange that color should be given for the charge of congressional extravagance. It has, in fact, been distinctly invited and encouraged by the change of rule and practice now pointed out.

3. A third element should perhaps be added, and that is the breaking down of the power and prestige of the chairman of the Committee on Appropriations, even as respects matters over which he has nominal control. When Mr. Randall was

chairman, he was practically a chancellor of the exchequer in the almost absolute veto power he exercised in the matter of granting money. Appropriations that he said should not be voted were not voted, and there was an end of it. He was able, in the last resort, to interpose his single masterful will, and in the face of clamor and complaint say in effect, "You shall not have this money because I will not let you have it." No doubt his character and the times made it possible for him to play the autocrat, as a less resolute man, backed by a less docile party majority, could not have done it. Still there has been, in the twenty years since he demonstrated the power of the position, a sad lowering of its dignity. No one will accuse the present chairman, Mr. Cannon, of being a man without a will of his own, or without a proper supply of pugnacity, yet he was overridden again and again in the last Congress. Probably never before did a chairman of the Committee on Appropriations protest so often in vain against what he called extravagance, or so frequently record his vote in the negative minority.

Mr. Cannon began the first session with a suitable assertion of the power which he ought to have, and of the aim with which he meant to wield it. His business, he fearlessly and truthfully proclaimed, was not, in the main, to make appropriations, but to prevent their being made. How many vicious money bills he succeeded in killing, we have no means of knowing. But that he tried to prevent a great many from being enacted into law and failed, the public records of Congress amply show. The process of deterioration in such a position as his is inevitable, once begun. Power consists largely in seeming to have power, and when you take away half the power, you run the risk of destroying all the seeming. The power which really remains no longer commands unforced respect, and is continually exposed to further attacks and weakening. The changes in rule and custom which broke the prestige of the chairmanship of the Committee on Appropriations were certain to lead to such humiliation and riding down of its occupant as Mr. Cannon had to suffer so many times during the two years past.

The one sure datum in the whole question is, that a representative body, empowered to spend money, is sure to spend it lavishly unless prevented in some way. It was a saying of an

old English financier, which has in it just the grain of cynicism necessary to give flavor to its truth: "If you want to raise a certain cheer in the House of Commons, make a general panegyric on economy; if you want to invite a sure defeat, propose a particular saving." That indicates the law, apparently the necessary law, of a popular assembly's being. If our Congress has been increasingly extravagant in recent years, that does not necessarily argue an increasing recklessness on the part of individual members. It may simply imply that the old checks on the innate recklessness of all Congresses, in money matters, have been removed or diminished. That they have been, it has been attempted to show in what goes before; and if successfully shown, the rationale of increasing congressional extravagance has been, in part at least, shown also.

What is to be the remedy? To what available checks on congressional wastefulness may we yet resort? Short-cut and infallible remedies are not to be hoped for. We shall have to agree with John Morley that politics, on its practical side at any rate, is one long second-best and choice between blunders. Such a radical change as the introduction of responsible cabinet government is an impossibility. We must do what we can with the material we have. Nor can we even expect to retrace our steps. It might seem a simple and obvious thing to climb the hill again — to repeal the permanent appropriations, to restore the power of which the Committee on Ways and Means and the Committee on Appropriations have been successively shorn, to make the Appropriations chairman once more the half of a chancellor of the exchequer — a chancellor, that is, on the spending side. But the separate committees have but tasted so much blood in the money bills given them, and their appetite is whetted for more. They will not give up a particle of the power they have acquired, and will always be able to vote down those who may want to take it from them. In this situation, the thing to be done is to look about among existing political forces and motives, and choose out those which may be brought powerfully into play against the tendency to national lavish expenditure.

The popular judgment, often blind and unjust, may guide us here. The people have a way of locating the responsibility for public extravagance, which may suggest the true place to fix it,

both in theory and practice. A French writer, in speaking of the "mania for responsibility" which is so prominent a feature of political life in France, says that for the people or the Chamber to vote down a minister or a cabinet affords them the same relief that an angry man experiences in going home and smashing the furniture. What the American people always smash in their rage is the party in power. Personal objects of their disapproval or anger, they are seldom able to single out; but the party as a whole is always there, ready for a drubbing. Specifically in this very matter of congressional extravagance have we the two historic instances of the popular smiting of the Back-Pay Congress, and the Billion-Dollar Congress.

Is there any way of making this party responsibility, of which the voters have thus a vague but vital sense, an operative force in the effective control of national expenditure? May we have responsible party government in this particular, if not responsible cabinet government? Two ways seem feasible. One would be, to give openly to the speaker of the house the power over legislation, including appropriations, which he now wields secretly, and to insist upon his having an acknowledged public responsibility, as leader of his party, as well as the private one which he now really has. In her recent admirable and striking study of "The Speaker of the House of Representatives," Miss M. P. Follet has shown how, through rule and custom, through the appointment of committees and the reference of bills, through the famous right of "recognition," the speaker is truly the American Premier, in all matters of domestic policy and legislation. We might at least insist upon making him our chancellor of the exchequer. That he is so now to a very great extent was tacitly confessed by Speaker Reed in his remark at the close of the session of 1896, that he regretted having been compelled so often to say "no." He might have said "no" many times more to the great advantage of the country. The point is that he has the power to say it, and to make his "no" absolute. Masterful speakers are all the while saying it. It would seem possible, therefore, to put into their hands, as the chosen leaders and organs of their party in Congress, and to put it there with party consent and submission, open and full control of the appropriations of Congress.

There are, of course, obvious and strong objections. Such power in the hands of a weak speaker would be woefully out of place. But weak men run less and less chance of being elected speaker at all, and the plan suggested would but make it all the more necessary to elect strong men. Even a strong speaker, it may be said, would not want such power, or want to seem to have it. But in the rapid evolution of the functions of the speakership, its real power is coming more and more clearly to be perceived, and it might not be so hard to compel even an unwilling speaker to accept the responsibility if he is eager for the power. No party would consent to give the speaker such power, it may be objected. Very possibly not, just at present. So great is the strength of political fictions that we may prefer to go on cherishing the illusion that our laws are made by Congress, when they are really made by the speaker, and to refuse him the ostensible, while leaving him with the real, responsibility for the appropriations of Congress. But a change may come after parties have alternately received a few more buffetings for extravagance, and they may be led to see the wisdom, from a purely party point of view, of putting themselves for safety in the hands of their natural leader in all such matters, the speaker of the house.

Meanwhile, an alternative, in some respects a more plausible and promising, plan might be found in the device of applying the party caucus and party discipline to the difficulty. A maximum expenditure, or at least a maximum for each of the chief branches of national expenditure, might be decreed in caucus, and the chairmen of committees empowered to enforce the decree. Then every loyal member of the party would be prevented, in combination with rebellious colleagues, or in league with party opponents (who are always willing, when in the minority, to heap up appropriations and make them as offensive as possible), from entering into log-rolling schemes to go beyond the limits fixed. These quiet little conspiracies, carefully worked up on non-partisan lines, and supported on the ground of mutual benefit, are the things that are death to congressional economy. The most frugal chairman goes down before them. Even the speaker finds it hard to head them off or break them down. But if all appropriations were made a strictly party affair, party

discipline would prevent these intrigues from coming to a head. A precedent may be found in party control of appropriations in the government of villages and towns in some states. At the nominating conventions, so much is agreed upon for public lighting, so much for roads and police and the fire department, etc., and the party winning the election always feels bound to adhere strictly to its own budget. That a similar course might be followed in a party caucus in Congress seems clear. The caucus determines more and more of party policy. Whenever things get into a bad snarl, a caucus is called to hit upon a plan by which all must abide. If a caucus can order men how to vote not only for officers but on a tariff bill, or an election bill, or on a question of foreign policy, it surely might assume the power to prevent members from driving the party into extravagant appropriations.

It may be objected that this would be to enhance the tyrannical power of party, when what we most need is to break it down. But wise government consists in doing the best possible with existing political forces. Party government is an established and, at present, an unchangeable fact. We cannot undo it, but we may make use of it. If a party can be made clearly and avowedly responsible for what the voters vaguely and angrily hold it responsible for in any case; if, through its single chosen leader, the speaker, or through its recognized organ of united action, the caucus, it can make good the impaired power of the purse, from which the American Congress is so plainly and so seriously suffering, it cannot be denied that to do so would be to put party government to the best possible use. One thing is certain, that, either in the way here hastily and roughly outlined, or in some other, the American people must speedily devise a check on a spendthrift Congress.

86. State Legislation. — Less attention has been given to the financial legislation of the states than to that of the national government. The procedure of the states is described by Professor E. L. Bogart, as follows: [1]

[1] Financial Procedure in State Legislatures, in Annals of the American Academy of Political and Social Science, 1896, pp. 236 *et seq.* Reprinted with consent of the author and of the Academy.

We can perhaps best trace the course of financial legislation in our commonwealths by following its progress in one state and then noting wherein the others differ from or resemble this typical one. For this purpose, and because the size of its budget entitles it to particular consideration, I have selected New York.

In New York, the fiscal year extends from Oct. 1 to Sept. 30. The lack of uniformity among the commonwealths in the fiscal year alone well exemplifies the differences and want of a unified system which exists in almost all fiscal matters. Eleven other commonwealths, together with New York, close their accounts for the year on Sept. 30; in fifteen, the fiscal coincides with the calendar year; nine have followed the example of the federal government and end on June 30; four each on Nov. 30 and Oct. 31: while the remaining six assert their independence by selecting dates which no other commonwealth has in common with them. However, it is principally in minor matters that such variety exists; in essentials we shall find considerable uniformity.

Early in October the comptroller issues his annual report to the Legislature, in which it is his duty to exhibit "a complete statement of the funds of the state, of its revenues, and of the public expenditures during the preceding year, with a detailed estimate of the expenditures to be defrayed from the treasury for the ensuing year, specifying therein each object of expenditure and distinguishing between such as are provided for by permanent or temporary appropriations, and such as require to be provided for by law, and showing the means from which such expenditures are to be defrayed."

The materials for this report are furnished the comptroller by the heads of the different departments, and of the various state institutions, by the canal, park, and other commissioners; by the various boards; by banks, corporations, etc. The various items are distinctly arranged under different heads, usually termed "funds," as the general fund, canal fund, school fund, etc. It being also a part of the comptroller's duty to suggest plans for the improvement and management of the public revenue, the tables of figures are prefaced by a written report and explanation of some of the principal items.

This introduction often contains some excellent advice and such information as would be of most benefit to the committees in framing new bills. As to whether the advice so offered will be followed, depends entirely upon the Legislature. The estimates are never anything but recommendations. When, as not infrequently happens in some of the states, the auditor and the Legislature are of different political color, the warnings contained in the report are more likely to be construed as an unnecessary interference by the executive in legislative business than as legitimate suggestions of a policy that ought to be followed. As a rule the comptroller has to beg for more economy on the part of the Legislature, rather than urge it to greater liberality. All of the reports, however, do not contain such prefatory or explanatory notes, many contenting themselves merely with the bare presentation of the public accounts.

The office of comptroller exists in eleven states only, but in most of the others an equivalent officer, the auditor, makes similar reports. In Oregon and Wisconsin, however, the secretary of state performs this duty; while in eighteen commonwealths the auditor's report contains a statement of the expenditures and receipts for the past year only, leaving to the legislative committees the labor of preparing estimates from these data for the coming year. In about half of the commonwealths the report is made to the governor and transmitted by him to the Legislature, while in the others it is sent directly to the Legislature; in Delaware, however, the report is made to a joint committee on finance, and in Vermont to the Committee on Ways and Means. In eight commonwealths a biennial report only is made.

These estimates are not read in the Legislature, though any member who desires can obtain a copy of the report and study the needs and resources of the state for himself.

The framing of the general appropriation and supply bills, which are based upon these estimates, is left to the House Committee on Ways and Means.

The Legislature meets annually on the first Wednesday in January, for a session of four to six months. The sessions of all the Legislatures, whether annual or biennial, are called in

January; if biennial, usually in the odd years, so as to avoid the entangling influence of a presidential election. The length of the session is limited in many states by their constitutions, the period varying from forty days in Georgia, Oregon, and Wyoming to one hundred in California. Mississippi limits every other biennial session to a period of thirty days; the intervening sessions being unrestricted as to length. Twelve states limit the period of the session absolutely; thus Louisiana provides that all legislation after a certain time shall be null and void. Five others, like Georgia, provide a term beyond which it cannot be extended, unless by a two-thirds or three-fifths vote, or in cases of impeachment. Virginia, in such cases, forbids an extension of more than thirty days; Missouri and Texas reduce the pay of members after a certain period. Again seven others, like California, cut off their pay entirely.

"The first few days of the session are occupied with the election of speakers and with the more or less disgraceful scramble for positions on committees by members in the interests of powerful corporations or political combinations."[1] By far the most important committee is the House Committee on Ways and Means,[2] and to the chairmanship of this committee of eleven members the defeated candidate for the speakership is always appointed. It is by no means unusual for a man to run as a candidate for the speakership, knowing that he cannot be elected, in the hope that he may secure votes enough to entitle him to this important chairmanship. This position makes him at the same time the recognized leader of his party on the floor of the House. The other most important man on this committee is the leader of the minority in the House, who belongs, of course, to the opposite party to that of the chairman. It is always the endeavor of the committee to report its bills as early in the session as possible, but they usually drag on to the last minute possible. With an energetic, possibly rather arbitrary, chairman, however, they are often made ready in a few

[1] Question of the Day, No. XXII. Defective and Corrupt Legislation, by Simon Sterne, p. 3.

[2] This name is used in about half of the commonwealths as in New York. In most of the others the equivalent committee is known as the Committee on Appropriations, which name designates much more aptly the duties of the body.

weeks. Provision is usually made for their early submission to the Legislature by some resolution or rule, if not by a constitu tional provision. Thus Rule 19 of the Joint Rules in the Legislative Manual for 1895, reads as follows: "The supply bill and annual appropriation bill shall be reported by March 15, and printed immediately thereafter, and made the special order for March 25, or some day prior thereto, immediately after the reading of the journal."

Some of the states have constitutional provisions forbidding the introduction of appropriation bills after a certain period of the session has elapsed, and many of them forbid their introduction within a few days of the end. But in New York this is left to the discretion of the Legislature itself. The provision, however, which was inserted in the Constitution of 1894, providing that all bills must be printed and on the members' desks at least three days before enactment, has the same effect, mainly of prohibiting the rushing through in the last day of appropriation bills, as to whose items no one possessed the slightest knowledge. It "prevents some of the worst evils which heretofore attended the closing days of the legislative sessions. The orderly and decorous procedure of the closing days of the legislative session of 1895 (and 1896), as compared with prior legislative sessions, attests the efficiency and wisdom of this Constitutional Amendment and shows that much good can be produced by the introduction of method and order and by properly systematized legislative procedure."

When the Committee on Ways and Means has been finally selected, it usually starts to work energetically to make a record for itself. Committee meetings are held frequently. The comptroller and heads of departments, bureaus, and state institutions are invited to attend and explain their needs and requests for larger or unwonted appropriations. Usually their estimates are cut down, since the committee wishes to come before its constituents with a reputation for economy. The relations between the committees and the heads of departments and other executive and administrative officers of the commonwealth are subject to no rule, but the various commonwealth officers volunteer information when they see fit, or when they desire changes in the previous grants, or when they are invited

to appear before the committee when the latter feels itself in the need of enlightenment. In many of the states legislative committees are invested by the constitution with all the power of a judicial body to take testimony and examine witnesses. The constitution of New York is silent on this matter. The commonwealth officers do not, of course, appear on the floor of either House, but confine their explanations to communications in the committee rooms.

Though by no means final, the estimates of the committee as presented in their bills are largely decisive as to the size of the grants made to the specific objects named therein. In this they have followed the precedent both of the English and our own federal government. "The Houses of the state Legislatures, too, being separated from the executive in such a way as to be entirely deprived of its guidance, depend upon standing committees for the preliminary examination, digestion, and preparation of their business, and allow to these committees an almost unquestioned command of the time and conclusions of the Legislature. As they have grown larger they have grown more dependent upon their advisory parts, their committees." The same criticism is pertinent to the state Legislature that may be made with regard to Congress, namely, that much time is spent by the committee in preparing plans which ought to be used discussing these plans before the whole House. This seems, however, to be an evil inherent in our present system of short terms and frequent changes. Every year a large proportion of the members of the assembly comes to its sessions without any legislative experience whatever or any intimate knowledge of the needs and resources of the state; every second year this is true of the Senate. A large portion of the time at the beginning of each session is, therefore, spent virtually in instructing these new men as to their duties, and financial measures which should be reported to the Legislature within a couple of weeks of the opening of the session are often delayed till the end.

In several of the states there are constitutional or statutory provisions requiring that legislative committees shall report bills within a certain time. In New York, Assembly Rule 15 was intended to effect this end by providing that it shall be the duty of each of the several committees to consider and report

without unnecessary delay upon the respective bills and other matters referred to it by the House.

Assembly Rule 60 also requires a report on all bills before a certain time. These provisions, however, are not complied with.

It is the practice in almost all the states for bills appropriating money to originate in the lower branch of the Legislature, though there are explicit provisions to this effect in the constitutions of four states only, Georgia, Louisiana, Nebraska, and New Hampshire. In Georgia the words "or appropriating money" are added to the provision that revenue bills shall originate in the House; in Massachusetts and New Hampshire it is provided that all "money bills" shall originate in the lower branch — a term broad enough apparently to include both the raising and appropriating of money. By a recent decision of the Supreme Court of Massachusetts, however, it has been decided in that state that bills appropriating money may originate in either branch of the Legislature.

As a rule the committee which prepares the bill, drafts it as well, without outside assistance, the chairman usually undertaking this work, or perhaps some member with a turn for legal phraseology. Only in Massachusetts, which state may serve as a model in fiscal as in so many other matters, are these bills prepared by a specially trained agent — in this case by the chief clerk of the Committee on Ways and Means, who is elected for that purpose. The loose and often dangerous phraseology of many of the laws passed by our state Legislatures has long been a crying evil, and its effects are quite as vicious in the case of financial legislation as in more general laws. Provision should certainly be made for the submission of all bills to trained lawyers or a carefully selected committee before their third reading while there is yet time for amendment, in order to correct any inconsistencies or undesirable items which may have crept in while they were being drafted; this plan has already received substantial recognition in legislative procedure in New York state, in the form of the Committee on Revision of the Assembly. By Rule 16 of that body this committee is charged with the duty of examining and correcting all bills prior to their third reading, "for the purpose of avoiding repetitions and unconstitutional provisions, insuring

accuracy in the text and references and consistency with the language of the existing statutes."

This rule was only adopted in 1890, since which time it has done a great deal of good; but to insure proper results a like committee should be appointed in the Senate, and both should be provided with counsel of experience and talent. At present the attorney-general is the only legal authority in the service of the state on whom the legislative committees can call for advice or information, and his time is too much taken up with the duties of his own office to permit him to devote any of it to this work. Of course such a committee considers not only financial measures, but all bills which are brought before the House.

In New York the Committee on Ways and Means prepares two bills — the annual appropriation bill and the supply bill. Of these the former includes the permanent appropriations, such as the salaries of the state officials, fixed appropriations to state institutions, etc.; the supply bill includes indeterminate and changing items of expenditure, such as appropriations for improvements on the canals, new state buildings, etc. The grants made by the appropriation bill are not good until the following October, while those made by the supply bill may be drawn upon immediately after its passage. As noted before, the general appropriation bill is passed toward the beginning or middle of the session, or at least comes up for discussion by that time; the supply bill is usually printed at the end of the session, just in time to meet the constitutional requirements, and is then rushed through without due examination or debate. It is, therefore, never possible to determine exactly what the appropriations of the Legislature have amounted to until the very end of the session; or, indeed, even then, for many bills making appropriations of the public money are every year left in the hands of the governor after the adjournment of the Legislature, to receive his signature. Not until these bills are finally disposed of, therefore, can the amount of the year's appropriations be exactly determined. For all practical purposes, however, the calculation made at the end of the session suffices.

There are some portions of the public expenditure which are not dependent on the annual grants of the Legislature, being provided for by statutes that run without limit of date. "In the

ordinary financial transactions of government it is the custom to prepare a budget giving all the receipts and then appropriating these receipts by grant among fixed objects of expenditure. Not so in the United States. In most of our commonwealths there is no general table of receipts to be appropriated by legislative grant for definite purposes. On the contrary, the receipts are divided among a number of separate accounts called funds, and the expenses again are defrayed out of these various fund receipts, each of these accounts being kept separate from the others."

The number of funds is entirely arbitrary, ranging from two to forty-six. Sometimes new funds are added by every Legislature when it is desired to take certain classes of receipts out of the general revenue and to place them in fixed categories beyond the reach of legislative whim. In Georgia and Maine we find a number of so-called funds which apply only to expenses and simply denote so many purposes of appropriation.

The proportion of those parts of the public expenditures and receipts which do not require to be legislated upon annually, but which are provided for by statutes which run without limit of date, differs greatly in different states.

There is no apparent rule in the matter which differentiates the commonwealths according to either age or geographical position, unless it be that the older commonwealths provide for their expenditures, and the newer commonwealths for their receipts, by means of permanent statutes rather than by current legislation. In Kansas, Mississippi, Nebraska, Nevada, Tennessee, Texas, and Washington all of the commonwealth expenditures are made in virtue of current legislation; in Indiana, Kentucky, Pennsylvania, South Dakota, and Utah, almost all are so made; in Michigan and Montana three fourths; in Minnesota and North Dakota about three fifths; in California, Colorado, and West Virginia one half. On the other hand, South Carolina and Vermont provide for nearly all of their expenditures by permanent statutes; Iowa and New Hampshire so provide for three fourths of theirs. When we turn to the revenue of the commonwealths and inquire how that is determined, we find a larger proportion of commonwealths establishing revenue by means of statutes which run without limit than was the case

with the public expenditures. North Dakota, Oklahoma, Pennsylvania, and West Virginia obtain all their commonwealth receipts in virtue of permanent statutes; Kentucky, South Dakota, and Washington raise almost all of theirs thus; Vermont and Massachusetts, four fifths and two thirds of theirs, respectively; Colorado and South Carolina, each one half. On the other hand, California, Indiana, Kansas, Mississippi, Nebraska, and Tennessee raise all revenue by means of current legislation; Michigan, all but educational funds; Nevada and Utah, almost all thus; Montana and New Hampshire, three fourths and two thirds respectively of theirs.

"The General Fund is found in all the commonwealths and corresponds to the budget of most governments. It consists of all the ordinary receipts not especially appropriated to other funds, and thus serves as a sort of dragnet of commonwealth finance." It will thus be seen that it is only over the general fund the Legislature can exercise unrestrained control, and in proportion as the amount of revenue which flows into this is diminished by permanent grants to other funds, just to that extent is the financial independence of the Legislature decreased. This is especially true of those commonwealths where the rate of taxation is limited by statute or constitutional provision, since in these the amount of state revenue is fixed, and can grow only with the increase in value of the taxable property of the state, or by finding new sources of revenue.

The main source of revenue for commonwealth purposes is the general property tax. Usually a certain percentage of the general taxes or a special commonwealth tax is devoted to the support of the free public schools; in a number of commonwealths a poll tax of small amount is levied for this or a similar purpose. In the same manner the proceeds of other taxes or sources of revenue are devoted to certain specific ends, and are removed entirely from the power of the Legislature to change them. Thus, though the Legislature may nominally dispose of large sums and make large grants to various objects, their real authority is very much circumscribed. This is especially true where any large part of the revenue is derived from trust or investment funds, and particularly so if the proceeds of these funds are devoted by statute to some specific object. Appro-

priations made under such statutes are placed on the annual appropriation bills and are submitted to the finance committees who have, however, no power to materially alter them. They can, at most, run up or down the scale of a certain number of appropriations which must in any case be kept up. . . .

When the appropriation and supply bills are introduced to the Assembly, which is usually done on a date before determined upon, the Assembly immediately resolves itself into committee of the whole. The bills are then considered item by item, and section by section, criticisms and suggestions being very freely offered by members of the committee. The bills are defended by the chairman of the Committee on Ways and Means, and explanations of new appropriations or changes in the old are made by him. It is always the endeavor of the Ways and Means Committee to have their bills passed with as little alteration as possible, and to this end they devote all their energies. It shows not only that they enjoy the confidence of the Legislature, but also that they are in touch with their constituents and familiar with their needs, and upon this they particularly pride themselves.

This is the nearest approach to the responsible English ministry, upon the acceptance of whose budgets depends their stay in office, which we possess. It is, however, less a matter of responsibility with our Committee on Ways and Means than a desire to make political capital out of it; to be able to point to the record made as chairman of that committee when putting forward a claim to the nomination for governor next term.

The Assembly is invariably delayed with amendments or with bills containing new appropriations by individual members. Members with pet little appropriation bills of their own endeavor to have them accepted by the Committee on Ways and Means, and to have them inserted in the supply bill, as they then stand a better chance of being passed than if they were exposed alone and unsupported to the fire of criticism of the House. Many of the states have inserted provisions in their constitutions forbidding the inclusion in the general appropriation bill of any appropriations except those "for the ordinary expenses of the executive, legislative, and judicial departments of the state, interest on the public debt and for public schools.

All other appropriations shall be made by separate bills, each embracing one subject." This provision prevents also the addition of "riders" to the general appropriation bills. It is found in the constitutions of Alabama, Arkansas, California, Colorado, Georgia, Illinois, Missouri, Montana, North Dakota, Pennsylvania, South Dakota, West Virginia, and Wyoming. A new section was inserted in the revised constitution of New York which aims to prevent this abuse in that state. It is as follows: "No provision or enactment shall be embraced in the annual appropriation or supply bill, unless it relates specifically to some particular appropriation in the bill; and any such provision or enactment shall be limited in its operation to such appropriation."

Although in accordance with a long-established precedent, bills appropriating money usually originate in the lower branch of the Legislature, the Senate has always reserved to itself the fullest possible privileges in the matter of amendments to these as well as all other bills. The Senate invariably makes amendments, if for no other reason than to show its right to do so, and to justify the popular belief that the Senate is a more competent body than the Assembly. There is not that great difference of opinion in the two branches, however, as to the proper size of the appropriations in our state Legislatures which distinguishes the passage of the federal appropriation bills by Congress. In the state Legislature it is difficult to say which is the more liberal or economical, though in the long run the Senate is probably the more conservative. As has been noted before, only four states have constitutional provisions as to the place of origination of appropriation bills. When such bills reach the Senate after having been sent from the Assembly, they are referred first to the Finance Committee, and then reported by it to the Senate. Their treatment in the Senate is similar to that in the lower branch; and after passing the Senate they are returned with their new figures and amendments to the Assembly.

In case the bills as returned are not accepted by the Assembly, a Conference Committee is appointed of members from each House to adjust the differences. They seldom fail to agree, and more often than not adopt the Assembly's figures

in the bill they finally report. It happens very infrequently that supplies are refused because of a failure to agree. The same mode of procedure is followed in all the states in this respect.

There is not the same chronic complaint of underappropriations heard in our state Legislatures, as in the case of Congress, where a deficiency bill is to be considered as regularly as the annual session opens. In fact there is greater danger of too large than of too small appropriations. Toward the end of the session, however, a supplemental supply bill is often introduced to make provision for deficiencies under the other grants or provide for new items of appropriation.

Such is, in brief, the method of dealing with general appropriation bills in the New York State Legislature. Far different is the treatment of individual appropriation bills introduced by members. As soon as the committees are organized any member can introduce bills, and the right is practically without limit until toward the close of a session; and then only because of the physical impossibility on the part of the committees of considering new bills and the practical certainty that they will be "smothered" if they are referred. Private appropriation bills are not necessarily referred to the Committee on Ways and Means, as might be expected, but to the committees on canals, cities, or what not, for which the appropriation is designed. In other words, if a bill making an appropriation for deepening the Erie Canal in a certain locality were introduced by a member, it would be referred to the Committee on Canals and reported by them to the House. As such a committee is made up of men who live along the borders of the canal and who are pledged to their constituents to spend money on it, there is little chance of the bill being unfavorably reported. It is chiefly in connection with these bills that "log-rolling," as this exchange of political favors is called ("you roll my log and I'll roll yours"), occurs, and of course the rooms of these committees are the chief scene of this sport. Mississippi is the only state whose constitution recognizes the existence of this evil and attempts to prohibit it by legislative enactment. "Log-rolling" is there defined as a felony, punishable by imprisonment of from one to ten years.

Hearings, usually anything but formal, are given to interested parties on proposed bills, and it is often possible to influence the chairman of a committee to report favorably. They are seldom averse to so reporting appropriation bills. When a day is appointed by a committee for hearings on a proposed bill, notice is given to the advocates of the bill; and if, by any happy accident, adversaries to the bill know that a measure is pending which they wish to oppose, they also have a chance to be heard. There is no attempt made to take proof and the treatment of bills at these hearings is anything but judicial. If the bill involves large interests, the more effective work is done by trained lobbyists. After a bill has reached the Legislature, too, its course may be and usually is favored by lobbying. So great had this latter evil become in some of our states that in three of them — California, Georgia, and Oregon — lobbying was declared a felony. In New York it is forbidden on the floor of the House.

The length of time for which appropriations are granted and during which they are available varies in different states. In New York, and in eight other states, the constitution provides that all payments under any specific appropriation must be made within two years of the passage of such appropriation act. All balances then unexpended revert, usually, to the general fund, unless reappropriated. In sixteen other commonwealths the period is limited by legislative enactment to two years, or a similar period terminating after the opening of the next session of the Legislature. In six of the commonwealths appropriations are good until they are exhausted or until the act making them is repealed. I could find no mention of the subject in either the constitutions or statute law of the remaining commonwealths, so that we may infer that no time limit is set to the period of their availability.

87. Municipal Legislation. — The procedure of American municipalities is described by Dr. F. R. Clow as follows: [1]

[1] The Administration of City Finances in the United States. In Publications of the American Economic Association, Third Series, Vol. II (1901). Reprinted with permission of the author and the Economic Association.

I. Reasons for the Development of City Budgets

For various reasons the cities of the United States have surpassed the state and federal governments in the development of their budgetary procedure. The chief reason is the situation the city finds itself in as regards revenue and expenditure.

Revenue comes mostly from a direct tax levied on the capital value of property. For two thirds of the cities the charters fix a maximum rate that may be levied, and half of these find it necessary to levy up to the maximum. Philadelphia, Nashville, and Richmond, though not limited by charters, have adhered to the same rates for many years. Then as local expenditures far exceed those of the state or county, the city rate is the most potent factor in making the total rate high or low. City councils are in closer touch with the people than state legislatures, and all taxes are assessed and collected by local authorities; so the city government feels the full force of the universal aversion to paying taxes, and will increase the tax rate only under dire necessity. For all cities, therefore, revenue is limited either by charter, or custom, or what the taxpayers will stand.

Consider alongside of this fact the multitude of services and the tremendous demands for expenditure which are being forced upon local government by modern urban life, under the direction of modern science and engineering. This means that city governments must "cut the coat according to the cloth," and apportion the limited revenue among the various services on a comprehensive plan in which all are given their relative importance. Haphazard appropriations like those of the federal government and of most state governments would be intolerable.

The restriction of city autonomy is an important factor. Under the tutelage of the state legislature the city government is often compelled to follow budgetary procedure, sometimes wholesome and sometimes not, which the legislature will not impose upon itself. One such requirement, existing almost universally, is that the city shall levy its tax for specific purposes — so much for schools, so much for parks, so much for debt — and not a single sum or rate for the aggregate expenditure; the limit to the tax that a city may levy is usually in the

form of limits to the taxes that may be levied for these specific purposes. Here we have the elements of a budget.

II. Forms of the Budget

It is convenient to divide the forms of the budget in use among the cities of the United States into three classes: 1. The bare tax levy, which is only a budget in embryo; 2. The tax levy preceded by detailed estimates, the latter remaining without legal force; 3. The tax levy accompanied by detailed appropriations, the whole constituting a well-developed budget. Each of these will now be treated.

1. The simplest form of budget is the bare tax levy. In Little Rock it is as follows:

	MILLS
General fund	5
Interest fund	$\frac{1}{2}$
Sinking fund	$\frac{1}{2}$
Total	6

These are the maximum rates allowed by law, and the city has not for years been able to get along with less; the tax levy, therefore, cannot be anything else and the city has practically no control over a large part of its revenue. The actual apportioning of the money in the general fund among the various departments is done by the city council when it makes contracts and allows bills from month to month. There is, of course, much informal forecasting and apportioning of this fund for a year in advance; some of the city officers and members of the council give the matter much thought; there is discussion between them in casual conversation, in the various council committees, and in the council itself. But other than the ordering of the tax levy given above, there is no regular formal action by any part of the city government which sets a limit to expenditures, either in the aggregate or by departments, for a year or any other long period, or which makes an official estimate of the revenue that will be available and may be counted on.

This elementary budget is probably the only kind that exists in many of the smaller cities of the United States. Even when the tax rate is not fixed by a statutory limit, there may be a

customary rate which remains unchanged from year to year. In such a case if the expenses also remain unchanged or grow only as the valuation of property grows, the officials may be spared the task of making an annual balance sheet or of estimating in advance either the revenue or the expenditure.

* * * * * * *

2. It is a long step in advance toward a complete budget when the forecasts of the receipts and expenditures for a year are put into writing, reduced to some kind of a system, and considered by the council when the tax levy is ordered. For example, the tax levy of Elizabeth for 1897 was as follows:

Public schools	$91,133.61
Streets and parks	18,500.00
Fire and hydrants	21,500.00
Police department	47,500.00
Charities	17,500.00
Street lighting	22,000.00
Printing	2,500.00
Public buildings	3,500.00
Salaries	10,900.00
Health, including scavenger	10,000.00
Sewers	2,500.00
District court	4,000.00
Expenses of assessing taxes	9,000.00
Contingencies and elections	6,000.00
Interest on debt	125,000.00
Total	$391,533.61

The board of assessment and revision of taxes was directed to "assess the sums mentioned above for the respective objects named." The budget as enacted consisted merely of the above fifteen items. But these items were the totals of a much larger number which were collected or estimated by the comptroller, and revised and accepted, though not enacted, by the city council. In 1895, the board of finance of Albany, then under its old form of government, submitted the projected budget to the council in the form of twenty-three items; but the details of this budget were given in "addenda" to the length of 310 items. After making a few slight changes, the council enacted the twenty-three items. The addenda were merely provisional forecasts and remained without legal force.

In these cases the budget consists of nothing but the tax levy. Any number of details may be used in the estimates, but the final enactment is merely an order on the taxing authorities to levy taxes for the benefit of a small group of funds. The middle-sized cities of the West and South use this form of budget more than any other. The value of a budget like this depends altogether on how it is carried out. During the year, as the council spends the city's money in authorizing contracts, ordering work done, fixing salaries, directing the purchase of materials, and in allowing the bills that result from these acts, it is not legally bound to adhere to the hundreds of items that were used in determining the tax levy; it is, however, morally bound to do so with reasonable faithfulness. Now a moral obligation like this is subject to every use and abuse. The council can often vary from the estimates, as the year's work progresses, in a way that will save money or secure better service to the public; but a corrupt gang in control of the council can let the estimates distribute the funds wisely, at the time of year when the making of the budget attracts public attention to the financial condition of the city, and later further their selfish ends by diverting the funds to purposes not named in the estimates.

3. The fully developed budget makes annual appropriations, thus fixing expenditures for a year, in connection with the levy of taxes for the year. For example, the budget of Boston . . . orders that "the respective sums of money hereinafter specified be and the same are hereby appropriated for the several departments, and for the objects and purposes hereinafter stated," and that these appropriations be met out of the money already in the treasury, out of the "current income of the year," and out of the taxes to the amount of $12,111,196 which are ordered to "be raised by taxation on the polls and estates taxable in the city of Boston." This form of budget has been growing in favor the past thirty years and is now used by nearly all of the larger cities and many of the smaller ones, notably in Massachusetts, New York, Pennsylvania, Indiana, and Illinois.

The example of Boston just given illustrates the simplest and therefore the best method of making the appropriations — at the same time the levy of taxes is fixed and in the same measure with it. The cities of New York and Illinois make the appro-

priations first and the tax levy afterward; in Illinois the law requires that at least ten days shall intervene.

In a few cities the opposite order is followed, the tax levy coming first and the appropriations afterward. In Denver, for example, the tax levy for 1898 was as follows:

	MILLS
General purposes	8.5
Parks	1.3
Sinking fund	1.4
Interest	1.6
Total tax levy	12.8

Immediately after this was enacted, the council divided the $870,000 which the rate of 8.5 mills was expected to yield for general expenses into twenty-eight items, making a fairly complete budget. This type of budget exists in Omaha, and one somewhat similar in Minneapolis.

In Cleveland the tax levy is both preceded by estimates and followed by appropriations. Thus the tax levy for 1898 was made in June, 1897, and consisted of fifteen rates for as many funds. It was preceded by a detailed estimate, running to 170 items which were prepared with great care. The rates in the levy were fixed so as to yield approximately the totals arrived at in the estimates. Then in the following January the council passed the appropriation ordinance which distributed the city's estimated revenue, but agreeing substantially with the estimates that preceded the tax levy. Providence follows a similar plan; the estimates are made in March, the tax levy is made in May, and the appropriations are made in September for the year beginning Sept. 1.

These three forms of the budget shade into each other. This is decidedly true of the first and the second, and between them a sharp line cannot be easily drawn. In one city there are no estimates beyond oral reports and discussions; in another the oral estimates are embodied in the minutes of the meeting; in another, written memoranda are used by some of the officers or committeemen and preserved for their later individual use; in another, some of the departments hand in detailed estimates of their probable needs; in another, these department estimates are preserved and variations from them permitted only with good

reason. The most convenient point of separation is this: If an estimate, going somewhat into detail, is made of all the revenues and expenditures, and if this estimate is laid before the city council, and used by it in fixing the tax levy or in forecasting the work to be undertaken during the year, and then kept on record so that it can be referred to later, we have a budget of the second class; if any one of these things is not done, we have only the embryonic budget of the first class. The point of uncertainty is whether the estimates go sufficiently into detail. . . .

Between the second class and the third there is some shading, though the distinction can be easily drawn. The estimates which are used by the council in fixing the tax levy, without being enacted, may be faithfully adhered to in distributing monthly appropriations during the year — more faithfully than the annual appropriation bills of some other cities; in practice all of the advantages of a budget of the third class are realized though we have only an informal budget of the second class. On the other hand, a budget of the third class which can be altered by a majority vote of the council may be so little regarded in the actual distribution of money during the year as to be almost valueless.

III. The Budget Year

The idea of time is always involved in a budget, the authorized expenditure and taxation being for a certain period. In the cities of the United States this period is uniformly one year. It is usually termed the fiscal year.

This term, however, is sometimes ambiguous. In Grand Rapids, for example, what is called the "fiscal year" begins on May 1, the date on which new officers enter upon the performance of their duties. But the budget year begins Aug. 1, while the treasurer and comptroller make their financial reports for a year ending on a Thursday in the latter part of April. Most of the departments make their reports for the official year "ending April 30," but some prefer otherwise; the year 1899–1900, according to the reports of various officers, ended as follows: mayor's clerk, May 5; the mayor, marshal, assessor, and some others, April 24; the treasurer and comptroller, to-

gether with some others, as stated above, April 19; poor commissioners, and city physician, April 18; veterinary, May 31; board of health, no date. In the same volume the police and fire departments give "fiscal exhibits" for the year beginning Aug. 1, 1898, ending July 1, 1899. The schools have a still different system of years: the report of the board of education is for the "school year ending Sept. 1, 1899"; the library committee reports for the "year ending Aug. 31, 1899"; the year ends Sept. 9 in the report of the president of the board of education, and Sept. 26 in the financial report of the secretary.

Richmond affords a similar example. The financial reports are for the year beginning Feb. 1, and that they call the fiscal year. Formerly the budget was made for the same year; but it has recently, beginning with 1898, been made for the calendar year. Most, though not all, of the departments report for the calendar year.

In such cases as these it would seem that the budget year was the one most worthy of being called the fiscal year and that the others should be called the account year, official year, school year, etc. It is, however, of much importance that the budget year and the year of the financial accounts and reports should coincide; also that the budget year be the year covered by department reports. The charter prepared and recommended by the National Municipal League is defective on this point, though the provision for uniformity and inspection of accounts would be likely to obviate the evil here mentioned.

The only cities in the writer's list that have the same year for budget, financial accounts and reports, and all the department reports, are Philadelphia, Worcester, Somerville, Troy, Atlanta, all in New Jersey except Elizabeth, and all in California except Los Angeles. Many others have the same year for all except the schools; the schools are often under independent boards and they have good reason for changing the year during the summer. The constitution of California requires that the fiscal year shall commence July 1; Los Angeles conforms to this requirement in making the budget, but for financial reports and some other purposes its year begins Dec. 1. State laws usually set a time, but permit cities to set a different time by ordinance. Changes

are accordingly not infrequent, though they are least frequent in the largest cities. With about half of the cities the fiscal year begins on Jan. 1. The others exhibit greater variety.

While not a matter of great importance, the fixing of this point should not be made indifferently. If other conditions permit, it should come when the financial transactions are the lightest. This gives time for the labor of closing the accounts for the old year and the opening of those of the new; the outstanding orders will then be at the lowest; large items of revenue and expenditure and works of construction will not be cut into and so divided between two years. It should also precede the heaviest expenditures by the shortest possible interval so that they can be provided for in the budget with the least liability to error. This time, at least in the Northern states, is certainly in the early spring; many kinds of work, such as the construction of streets, are then at the lightest, but will be the heaviest during the six months immediately following. That these considerations are already taken into account to some extent is seen in the fact that of the list of cities given in the Appendix, twenty-one begin the fiscal year in March and April, while only one begins in August, two begin in September, and three in October.

Changes of officers should come at the beginning of the fiscal year, or near enough to it to allow each administration to make and carry out its own budget. The majority of cities follow this principle. When elections come in the autumn, the fiscal year begins in December or Jan. 1, and the change of administration is made then; this arrangement exists extensively in New York and New England. The legislature of New Jersey in 1901 changed the time of city elections from spring to fall. Elsewhere municipal elections nearly always come in the spring, and the change of officers also. The tendency to change the fiscal year then has just been noted, but something like a third of these cities with spring elections change the fiscal year Jan. 1. Maladjustments also exist in Buffalo, Ft. Wayne, Louisville, Little Rock, and New Orleans.

Regard should be had to the time when the taxes are levied and collected, which is usually uniform for the state. If the budget is based on the tax levy, it is desirable that the fiscal

year should begin near the time the levy is made. To have the fiscal year begin six months after the levy of taxes for it, as in the case of Cleveland, is to be unable to foresee the demands of the various departments to the best advantage.

On the other hand, to have the fiscal year begin six months before the tax levy is actually put into operation, as in the case of New York, means that the taxes will not come into the city treasury until near the end of the year for which they are levied. The city must then make temporary loans to anticipate these taxes and pay expenses during the greater part of the year. If, as is often the case, a considerable portion of the taxes cannot be collected until after the year for which they are levied has expired, some of these temporary loans may have to be carried over into the next year, with the result of making the accounts much more complicated and difficult to understand, as well as opening the door to deficits and floating debts.

IV. The Estimates

A budget begins with the department estimates, or perhaps more accurately, with the call for the estimates, for the heads of departments could not be relied on to think of the matter in time without a reminder. In the larger cities a formal notice is sent to the departments, like the following used by the auditor of Providence: "You are requested to furnish this department, on or before the first Monday in March next, an estimate of the amount of money that will be required by your department for the fiscal year ending September 30th, 18—, and an estimate of the receipts for the same period." The printed form then gives an extract from the ordinance which requires the furnishing of these estimates.

The preparation of these estimates is sometimes required by the charter and sometimes done as a favor to the officer or committee charged with framing the budget. But it makes little difference what the legal requirement is, as heads of departments are ready enough to make their needs known; in Boston the charter says that the estimates shall be sent to the mayor in January, but in practice they are sent when he calls for them, and that is usually in December. In the smaller cities like

Bangor, Burlington, Covington, Des Moines, Elizabeth, St. Joseph, and Sioux Falls, the departments make no formal estimates, but state their wants orally; and in some cities as large as Milwaukee, the department estimates are not considered of sufficient importance to be put in print.

The department estimates are delivered to the head of the finance department in every city that had over 200,000 inhabitants in 1900, except Boston. In all Massachusetts cities they are delivered to the mayor, and in all California cities to the auditor. In other states in cities below 100,000 population the estimates more often go directly to the council or the budget committee. A number of cities, following the example of New York, have executive boards which receive the estimates.

The department estimates almost invariably call for expenditures beyond the city's means of payment, and upon some one must fall the difficult and thankless task of cutting them down. When they go to an executive officer, as the mayor or comptroller, he ordinarily revises and compiles them. Rarely, as in Mobile, he uses them only as a basis for his own estimates which he sends on to the council. Sometimes, as in Minneapolis, he transmits them to the council just as they come to him, without adding any recommendations of his own. But ordinarily he sends on both the original estimates and his own revisions, arranged in parallel columns, perhaps with the appropriations for the previous year in still a third column. When the department estimates go directly to the council, all of this work is done by a committee; usually it is the finance committee, occasionally the committee on budget, ways and means, or appropriations. This task of working up the department estimates into the project of a budget requires so much study of details and so many arithmetical operations, that it can be conveniently and justly performed only by one person, or perhaps by two or three working together. A larger body can only bungle the work and follow the direction of one or two irresponsible leaders. But when once the task has been accomplished by the hand or under the leadership of an officer possessing a fair amount of common sense reënforced by a thorough knowledge of the city, and who commands the respect of the council, the budget is as good as made. To increase an item

or introduce a new item, it is necessary either to raise the tax levy, which is often impossible and always so unpopular as to be done only in extreme cases; or to strike out or reduce some other item, which is certain to encounter spirited resistance. A change raises so much discussion and takes so much time that the council cannot make many changes even if the requisite majority does favor them. Over and over again the writer has received testimony to the effect that the comptroller or mayor in revising the estimates really makes the budget. One very remarkable instance is found at La Crosse, where the comptroller made the budget during his eight years of service; only once during that time did the council make any change, and then only to the extent of a single item. It is only by paying very little attention to the recommendations of the mayor or comptroller, where any are made, and doing the whole work *de novo* by its own committee, that the council can be much of a factor in making the budget. Such appears to be the case in Chicago and many other Western cities.

In a small city the proper person to make the budget is the mayor. He is usually a person of great influence in the town, and also with the council — as the comptroller sometimes is not. He is in close touch with every department and is in position to judge wisely of their needs. He can also command the assistance of any subordinate officer; in Boston, for example, it is understood that a large part of the work of making the budget has long devolved upon the auditor, though it is nominally the mayor's function; the exact share borne by each depends entirely on the qualities of the two men holding the offices for the time being. But in large cities there is good reason for committing to the comptroller the task of framing the budget. He is always, presumably, an able man; he is not burdened with such a multiplicity of duties — official, political, and ornamental — as is the mayor; his term of service is frequently longer than that of the mayor; and he knows the details of the receipts and expenditures of all departments better than any one else.

V. Executive *vs.* Council Responsibility

This executive initiative in making the budget does not prevail in the smaller cities of the West, and exists still less in those of the South. But it is thoroughly established in the largest cities everywhere, and even exists in the smaller cities of the East. There the state legislatures not only give the executive of the city the initiative, but sometimes restrict the power of the council to change it. In Indianapolis and Worcester the council cannot increase the estimates. In Buffalo and Cambridge a two-thirds vote of all the members of both branches of the council is necessary to alter the estimates of the comptroller. The estimates for Washington and the District of Columbia are revised by the secretary of the treasury.

The most noted example of executive responsibility for the budget was afforded by New York City from 1873 to 1897. The budget was made by the board of estimate and apportionment, consisting of the leading executive officers. The council had the privilege of considering the "provisional estimate" and making changes in it. But as the board of estimate and apportionment might overrule any such change in passing the "final estimate," the council rarely made any.[1]

While this system was in existence in New York, a board of finance was established for Albany with power to submit estimates which could be amended only by a two-thirds vote of all the members of the council. The New York plan was closely copied in Troy; there was one difference, considerable in form but slight in reality: the council had power to reduce the estimates but not to increase them, and only the mayor's veto could overrule the action of the council. The Troy modification has now been adopted in the Greater New York charter, and in the law for cities of the second class in New York State. In these three cases the board is composed of five ex officio members, though with slight differences in the officers selected:

[1] The establishment of the New York Board of Estimate in 1873 followed the extravagance and corruption of the Tweed régime. It succeeded in protecting the city's credit, and proved advantageous in various other ways. Whether the device has materially reduced the city's taxes is another question, about which there may well be differences of opinion. In theory, it should be advantageous to have the preparation of the budget intrusted to those officials who have to carry it into effect.

BOARD OF ESTIMATE AND APPORTIONMENT

NEW YORK [1]	TROY	SECOND CLASS CITIES, N. Y.
Mayor.	Mayor.	Mayor.
Comptroller.	Comptroller.	Comptroller.
Pres. of dep't of taxes and assessments.	City engineer.	City engineer.
Pres. of council.	Pres. of council.	Pres. of council.
Corporation counsel.	Chamberlain.	Corporation counsel.

This New York idea of creating an executive board to make the budget has been imitated extensively. The new charter of Baltimore copies it almost exactly; even the officers composing the board are the same as in cities of the second class in New York. Something of a similar kind, though without such extensive powers, now exists in New Haven, Detroit, Saginaw, Superior, Minneapolis, Sacramento, and several other cities.

VI. The Budget Ordinance

The drafting of the budget ordinance is done very often, though not in the majority of cases, by the city's official legal adviser, styled variously as the city attorney, the city solicitor, and the corporation counsel.

When the comptroller or the mayor revise the estimates, they sometimes draft the ordinance at the same time. When the making of the budget is exclusively in the hands of the council, the chairman of the proper committee most often prepares the draft.

After what has been said it is evident that the procedure in the council itself is of small importance, although it is there that the entire responsibility of the budget nominally rests. The various readings — by title on introduction, after the report of the committee, and before the final vote — the higgling between the two branches of a bi-cameral council, the calling of the yeas and nays, the publication in the newspapers, etc., are things that need not be treated here. A single illustration will be given of

[1] An amendment made by the legislature in 1901 changes the membership of the New York board:

"The mayor, comptroller, president of the board of aldermen, and the presidents of the boroughs of Manhattan, Brooklyn, The Bronx, Queens, and Richmond shall constitute the board of estimate and apportionment."

what the council does with a budget. In 1893 the city council of Chicago passed the appropriation ordinance on March 27. After a large amount of other business had been disposed of, covering thirty pages in the printed proceedings, the council took up the special order for the evening, the consideration for the first time of the report of the committee on finance on the appropriations for 1893. Twenty-one proposed changes were defeated; four items were reduced; three were increased; one item was divided into four. Before that session adjourned the budget carrying $11,810,969 in over five hundred items had been enacted.

The cities where the veto is withheld from the mayor are few. Buffalo, Charleston, Detroit, Norfolk, San Francisco, Worcester, and Wheeling are the only ones in the list, that the author has found. All of the newer charters make the mayor's veto really effective as regards appropriations, by allowing him to veto items while approving a measure as a whole. The cities where some other than a two-thirds vote is required to pass a vetoed budget are the following: Nashville, a majority; Allegheny, Philadelphia, Pittsburg, and Providence, a three-fifths vote; Baltimore, Los Angeles, Vicksburg, and Superior, a three-fourths vote; Albany, under the old charter, Cincinnati, and Dubuque, a four-fifths vote; New York, a five-sixths vote.

VII. Completeness and Unity of the Budget

The number of items in the budgets varies from 13 in the tax levy of Youngstown, to 2071 in the appropriations of New York. For some of the larger cities the numbers in recent budgets were as follows:

Atlanta	113	New Orleans	307
Baltimore	288	Oakland	464
Boston	72	Providence	77
Chicago	536	Richmond	99
Cleveland	170	St. Paul	167
Indianapolis	136	San Francisco	130

In the smaller cities the items rarely exceed 100, and often are as few as 20.

* * * * * * *

The budget of Greater New York for 1901 contains 774 items for interest on debt, and 221 for principal; also 1076 other items, making a total of 2071. Many of these items are complex, as indicated above.

Does the city budget bring into one balance sheet all the proposed financial operations of the city for the budget period? This question must be answered all but universally in the negative. The writer has found only two examples of a complete budget — in Lynn and Cambridge. In February, 1897, the joint standing committee on finance of the Lynn council, submitted the plan of a budget, which is here given in condensed form:

RECEIPTS

Taxes, for city (at maximum rate, $12 per $1000)	$509,520.38
Taxes, for debt charges,	
Interest	100,000.00
Sinking funds	116,500.00
Receipts in departments,	
(11 items)	106,580.26
Loans,	
(3 items)	60,000.00
Total	$980,600.64

Then follow the appropriations in fifty-nine items which likewise aggregate $980,600.64. This budget clearly is intended to embrace all the incomes and disbursements of the city for a year, except temporary loans to be repaid before the year expires. The Cambridge budget is similar to this.

In Boston this completeness has been attained by making two separate budgets. There a clear line of separation has long been drawn between ordinary expenses and permanent improvements. The latter are met by loans, the former out of revenue. The budget has always included only the ordinary expenses and revenue. Up to 1897 the permanent improvements and the loans to meet them were made without any system whatever; but in that year Mayor Quincy inaugurated the practice of making a "general loan order," or budget of extraordinary expenses. The mayor called on the departments for estimates, the same as for the ordinary appropriations; these he transmitted to the council without change or recommendations of his own. The

loan order was then prepared by the committee on finance, in consultation with the mayor and the heads of departments. This procedure, however, has not been continued. The Michigan act of 1873 relating to cities apparently aimed to secure the making of a complete budget. It required the annual appropriation bill to appropriate all money to be received by the city, including special assessments and loans, to cover all of the expenses. But this aim has not been fulfilled. The same could be said of municipal legislation in other states.

An informal forecast of the amount the city will borrow and what shall be done with it is of course usually made, certainly where the city's debt is near the limit. But careful search and inquiry have failed to reveal other cases where a formal budget is passed to include all expenditure from loans.

The question is next on the revenue which arises from other sources than taxes; are the incidental receipts of the departments, the license fees, the interest on bank deposits, etc., included in the budget or not? The nature of city budgets, as already presented, doubtless suggests a large part of the answer. In the great majority of cities, the budget consists of the tax levy, with the estimates that precede it or the apportionment that follows it. The budget has its origin in the tax levy. Therefore those cities that have developed the budget but little from its original character do not include in it the miscellaneous revenue; it is left in the departments where it arises, or devoted to specific purposes; it sometimes does not appear at all on the books of the treasurer, the departments being permitted to spend their miscellaneous receipts without accounting to him for them. Where the budget is most highly developed, there such revenue is included and is formally appropriated along with the revenue from taxes. Many cities, of which Chicago is a good example, are in a halfway stage. They estimate the miscellaneous revenue, but leave it in the departments where it arises, subtracting it from the estimated expenditures of those departments before making the tax levy for them. The distinction between throwing the revenues all into one sum to be appropriated and using them to reduce certain estimated expenses for which appropriations are to be made may seem fanciful. But the latter method prevents the budget from

becoming a conspectus of all the proposed financial operations; it gives only a partial budget, and so complicates the financial system; besides, it facilitates certain abuses.

Among the cities where all revenue of all kinds is estimated and appropriated as part of the resources of the treasury are Lynn, Boston, Cambridge, Manchester, Rockford, New Orleans, and Augusta. Though not all of the remaining cities have been investigated on this point, a majority of them probably estimate the miscellaneous receipts, but use them only to reduce the regular appropriation without bringing them into the budget.

VIII. Accuracy of the Estimates of Revenue

The budget consists of a balanced statement of estimated and authorized receipts and expenditures. How nearly does the forecast correspond with the outcome? Here the cities are in about the same chaotic condition as the federal government; there has been little serious effort to make them correspond. Some cities have gone on for years overestimating the revenue, allowing expenses to break entirely loose from the estimates, and ending each fiscal year with a deficit.

Expenditures may not exceed the budget estimate unless permitted to do so; it is possible to *make* them conform. But that sometimes would cripple the service; and therefore nearly all cities have provision for allowing the estimates for expenditure to be exceeded; the modes of allowing this will form the subject of the next section. Revenue, on the other hand, cannot be forced to the square and the rule. A given tax levy or a certain scale of fees will produce sometimes more and sometimes less. It is from overestimating receipts that deficits more often arise.

Unfortunately the published annual reports give very incomplete data regarding the estimates of revenue. They include the tax levy or the budget in barely a majority of cases; and the cities that publish the estimates of miscellaneous revenue are fewer still; Boston, Providence, Portland (Me.), Philadelphia, Baltimore, and Richmond, publish itemized statements of estimated and actual receipts in parallel columns.

(Dr. Clow then presents data showing that miscalculations often occur, especially in estimating the probable receipts from taxes on property. Erroneous assessments or tardy payments usually account for this. New York, Baltimore, Boston, and a few other cities, have been more careful at this point.)

IX. Time of Making the Budget

The accuracy of the forecasts depends much on how long they have to be made in advance of the time to which they apply, and in this respect there is great divergence. Washington is united with the federal system and so makes the estimates nine months before the fiscal year begins. Detroit, Ft. Wayne, and Minneapolis make the estimates four months in advance and pass the budget three months in advance. Nearly as early are Buffalo, La Crosse, Norfolk, and Tacoma. New York cities all complete the budget before the fiscal year begins. So do New Haven, Providence, Savannah, New Orleans, and Pennsylvania cities except Pittsburg and Scranton. The two last named, and all the other cities, as far as determined, pass the budget after the fiscal year begins. In a majority of them the estimates are made within the first month and the budget is passed within two months. Cincinnati, Evansville, Louisville, Newark, Oakland, and Wheeling make the estimates for the year two or three months after it begins; while Boston, Cambridge, Chelsea, Chicago, San Francisco, and Worcester are often as late in making the appropriations. Latest of all come Holyoke, Richmond, Wheeling, Louisville, and Newark; the last named makes the tax-levy budget six months after the year begins. Only three cities are found — Boston, Pittsburg, and St. Paul — that make the estimates before the beginning of the year and the budget after it.

The proportion of cities that do this important work of making the budget long before or long after the fiscal year begins is surprisingly large. It is probably due mostly to the mere crudity of budgetary procedure. The fancy for certain dates for the beginning of the fiscal year may have something to do with it. January 1, the favorite date, is on the average no

farther from the time of budget making than the average of other dates; but the dates from July to December are decidedly distant, while those from February to May are the nearest. One reason for this doubtless is that making the assessment of property is outdoor work and is not often required in winter, but usually in the spring and early summer. So the tax levy also tends to come near that time. Other reasons have already been given why the budget should be made in the spring. With the necessary connection between the time of making the budget and the beginning of the fiscal year, the former should govern and the latter should be adapted to it. All that can be said in favor of beginning the fiscal year on Jan. 1, is that the calendar year begins then and private business accounts are generally balanced then — quite superficial reasons.

During the time at the beginning of the year when, in many cities, there is no budget in force, the general practice is to pay the regular salaries and keep up all necessary work, but to engage in no new or occasional work. Chicago passes a temporary ordinance allowing 75 per cent of the fixed salaries to be paid; but all other necessary work is carried on absolutely without money. Richmond allows full pay to regular employees by an ordinance passed in December, but leaves all other claims unsettled. Massachusetts exhibits a variety of arrangements on this point, as the cities all make their budgets after the fiscal year begins and they are all under special charters so that variety is encouraged. Salem passes a provisional budget of twenty items that will run the departments three months if necessary. The Boston charter allows the departments to spend not over one third of their appropriations for the previous year before the new appropriations are made. Holyoke has the same arrangement. Worcester permits one fourth of the previous appropriations to be spent; Lowell, one sixth during the first two months. Cambridge carries this method of proportions to its logical conclusion and allows one twelfth of the previous appropriations to be spent during each month of the new year until the budget is completed. This plan is also followed in New Jersey.

Under proper regulations, there is no looseness involved in running a few weeks into the new year without a budget, and it has several advantages. It allows the estimates to be made

that much nearer to the conditions they are intended to meet. It permits of using the complete accounts of the preceding year as a basis of the estimates. In several cases it would remedy the defect before noticed of having the budget made by one administration and executed by another. It would avoid the haste which is sometimes necessary to get the budget through before the close of the old year. The mayor of Nashville complained in 1896 that passing the budget just before the close of the old year virtually deprived him of a veto on it, as to do so would suspend all the operations of the city.

X. Correcting the Budget

It is not in human foresight to provide for all the needs of a city a year in advance. Local financiering, as well as national, has to meet the unexpected. The fire department loses an engine at a fire; it must be replaced immediately, though the budget did not provide for it. A snowstorm, the like of which comes only once a decade, imposes such a task on the street-cleaning department that the appropriation ample for ordinary years is not now sufficient. A violent rain may so damage the streets as to make extensive repairs necessary. Similar causes of large unforeseen expense are floods, plagues, riots, fires, accidents to valuable works, and judgments rendered by the courts.[1] In such cases the Procrustean method is inadmissible, and probably no city has always followed it.

A few instances are found where the budget is subject to a regular revision in the course of the year; Troy under its charter made a preliminary budget just before the beginning of the

[1] The claims which give rise to these judgments originate in personal damage due to defective sidewalks or streets, the condemnation of real estate for municipal purposes, contracts, etc. Over these expenditures the financial officers of the city have no direct control, and only more or less indirect control. In the great cities, notably, New York, Philadelphia, and Chicago, these expenditures run up into the millions. In New York in recent years the corporation counsel has confessed judgment in suits to such an extent as to give rise to serious inquiries and cause a controversy with the comptroller; the result was the passage of two laws at the suggestion of the comptroller requiring the corporation counsel to obtain the approval of the comptroller or of the board of estimate and apportionment before instituting condemnation proceedings or confessing judgment. See Annals, xvi, 148–149.

fiscal year; this controlled expenditures for six months; then the final estimates were made on which the tax levy was ordered. Atlanta passes the regular budget in January, but revisions based on estimates from the departments are made in June and October. New Orleans and Cincinnati pass semiannual appropriations in addition to the annual tax-levy budget. St. Louis passes a regular appropriation bill toward the end of the fiscal year to cover deficiencies. Louisville passes a final appropriation ordinance in the last month of the fiscal year, which supersedes the former one; this disposes of all surpluses and deficiencies and makes it possible to close the year with clean accounts. In Cleveland the council may amend the annual appropriation ordinance three times in the year — on the first Mondays in May, September, and December. This looks like a very regular and orderly procedure, but it is a question if bad results might not flow from it. Anything that lessens the importance of the original budget is an evil, and a formal revision to which all might look forward would certainly do that. Then at the end of the year it would be less apparent which departments had kept within the appropriations and which had overrun.

The easiest and simplest way to let a department exceed its appropriation is to allow it to overdraw and say nothing about it. This of course requires the consent of the authorities who allow claims; they, however, must be sticklers for forms or be themselves under severe compulsion not to allow an occasional overdraft, especially as there may be no immediate harm in it; the purpose is a worthy one and there is plenty of idle money in the treasury. But it involves all the remote consequences of any official disregard of a principle. Frequently severe penalties are attached, such as making the guilty officials personally liable for the amount of the overdraft. In Dallas, Elizabeth, Tacoma, Sioux Falls, Manchester, and several cities in Ohio and Massachusetts overdrafts were admitted to be no more or less frequent, though contrary to law. Overdrafts are least used in the cities where the council orders payments, because the council is able to provide a regular means of covering the deficit; though they are authorized by the council in a way not strictly legal in Burlington, Lowell, Savannah, and Mobile. In Superior and Milwaukee the council allows them

by a three-fourths vote. The Buffalo charter allows overdrafts in the following terms:

"The expenditures for each department, office, or other purpose during the fiscal year, shall be kept within the estimate made for it, except that in cases where the mayor, comptroller, and treasurer shall certify in writing that a greater amount than provided for in the estimates is necessary in any department of the city, the expenditures in any such department may be increased by the amount so certified by a two-thirds vote of the members elected to each board composing the common council, which vote shall be taken by calling the yeas and nays, and shall be entered upon the journals of the common council."

The most prevalent means of correcting the budget is by transferring money from one appropriation to another. This avoids the irregularity of the overdraft, and at the same time uses any actual surplus in the treasury to fill the deficit in certain departments. The general rule in New York, Wisconsin, and Iowa is to prohibit transfers altogether; Michigan and Minnesota prohibit them for some cities. Boston allows transfers on the written recommendation of the mayor approved by a two-thirds vote of the council; but the budget order always provides for transfers by the auditor and mayor between the items of any department and, during the last two months of the year, between departments. Richmond likewise requires a two-thirds vote. In Ft. Wayne the council may make transfers on the recommendation of the comptroller. The practice is often carried to great excess; at Saginaw, for example, out of forty-eight funds, transfers were made in 1897–98 from twenty-seven funds, and transfers to eighteen funds; eight funds both received and gave transfers. The amount transferred was $56,454.78 out of a total expenditure of $712,712.80.

Certain funds are nearly always exempt from transfers, such as money realized from the sale of bonds, the receipts of productive enterprises like waterworks, and money raised for schools and for departments under state commissions.

No vital objection can be made to transfers if they are kept within narrow limits. The best way to limit them is probably to require a recommendation from the comptroller or the mayor or both, and a two-thirds or three-fourths vote in the

council. But transfers do most emphatically complicate the accounts and help to render the published report a mystery to the uninitiated.

By all odds the most direct and the least confusing mode of giving elasticity to the budget is to leave an adequate margin of revenue which can be used for exigencies in any department. This mode is adopted in Boston. The appropriation bill provides for a "reserved fund" amounting to from a fourth to a half of one per cent of the total appropriation; "and the city auditor is hereby authorized to transfer from this fund for current expenses only, as the mayor may direct, with the approval of the Committee on Finance." The law governing the city of Cincinnati requires that in the semiannual budget $50,000 shall be set aside as a contingent fund to meet deficiencies; this can be used only by a two-thirds vote of the council and with the approval of the mayor. In Minneapolis twenty votes out of twenty-six are necessary to make an appropriation from the contingent fund.

One small disadvantage of a reserved fund like this is that it requires the city to keep on hand a somewhat larger cash balance than when any surpluses that exist can be made use of by transfers or by the overdrafts of other departments. But the serious difficulties with such a fund are the political ones. When the makers of the budget are struggling to squeeze the estimates of the departments within the limits of the city's revenue, they must have great self-control to leave a dollar of possible revenue unappropriated; a city council that will do it voluntarily is rare indeed. On the other hand, when the charter requires that certain miscellaneous revenues shall go into such a reserved fund, the fund may become needlessly large and offer an irresistible temptation to spoliation. Newark affords a curious illustration of this. The contingent fund is fed by the license fees and a few other sources of revenue. It is very large, amounting to nearly ten per cent of the entire income of the city. When the council passes the tax ordinance, it also passes a "supplementary" resolution distributing the greater part of this fund to the various departments. Then even when the budget makers are able to leave a small sum unappropriated, the officers who control expenditures will have no peace until it is gone; as

long as it stands on the accounts unused it invites onslaughts by advocates of innumerable projects — absurd, visionary, partisan, or mercenary, and some really meritorious — but all beyond the city's ability to pay for. Most officers who have had experience with such matters are unwilling to stand the pressure and prefer to have no reserved fund, notwithstanding the incontrovertible reasons for having one. The writer has found that nearly every other official who performs the part of "watchdog of the treasury" has some secret or roundabout means for accomplishing the purpose of a reserved fund, such as to intentionally underestimate the miscellaneous revenues or overestimate some item of expenditure, or keep still about some surplus which he knows will not be needed, but which is ostensibly pledged. He can then exhibit the accounts to those clamoring for money and challenge them to show where the money can come from, while he knows all the time where it might come from. Here also may be a reason why some comptrollers do not wish the accounts to be too simple or easily understood; it would not then be so easy to plead poverty to the importunate alderman or department chief.

So far only additions to particular portions of the budget have been considered. Transfers cause no change in the aggregate; supplementary appropriations out of surplus resources do not cause a deficit; the chief end of the budget — to keep expenditure within the income — is attained. But a leak soon becomes a torrent, and if one department succeeds in spending more than its allowance, others will strive to do the same. It is by additions to the estimated expenditures, or by a shortage in the realized income as compared with the estimated income, that the city is made to close the fiscal year with a deficit.

There are several ways of allowing the total outgo of the year to exceed the total resources. The simplest one is to merely let the bills remain unpaid till the next fiscal year. This is a trick easy to accomplish and difficult to detect while in progress. A device, formerly much used but now happily disappearing, is to issue the usual orders or warrants to the claimants, but let them remain outstanding till some money comes in. . . . The most businesslike way is to issue certificates of indebtedness

or make loans at the banks, such as are frequently used to anticipate the taxes during the year, and let them run over into the next year. In some of the Southern and Western states the law allows expenditure to be made in excess of the amount specified in the budget, provided it is sanctioned by the voters at a special or general election. A law to that effect was recently passed in South Carolina. But the end is always the same: a floating debt is accumulated and future generations are required to pay for the folly or extravagance or corruption of the past. A floating debt, once started, tends to grow; some unpaid bills, outstanding warrants, or certificates of indebtedness must go over into the next fiscal year anyway; they thus show the way to making the expenditures of the year exceed the revenues.

CHAPTER XXVI

THE CUSTODY AND DISBURSEMENT OF PUBLIC MONEY

88. The Methods of the Federal Government. — Professor J. B. Phillips, after a careful study of the various methods employed by the federal government, presents the following conclusions:[1]

Having now described the various methods of keeping the public money which have been employed since the organization of the government, it is proper to conclude this historical survey with some discussion of the relative merits and demerits of each. In order that such a discussion may be as effective as possible, perhaps it will be best, first, to set forth as clearly as may be, the chief requirements of an effective plan for the administration of the public funds. With these requirements in mind, it will be easy to test each of the several methods by this standard, and ascertain its advantages and defects. The chief requisites in a perfect system of keeping the public money appear to be the following:

1. Whatever the system employed, it should provide for the absolute safety of the public money. This is so obvious that it needs no comment. However great the other advantages of a system, they cannot compensate for a defect which casts the slightest suspicion on the safety of the funds.

2. The money should always be under the absolute control of the government. By this is meant that the drafts of the government will always be promptly met. No system which does not admit of this should be considered for a moment. The great problem is to provide such a system as will insure prompt payment, and at the same time cause no friction in the money market.

[1] Methods of Keeping the Public Money of the United States, 138 *et seq.* In Publications of the Michigan Political Science Association, Vol. IV. Reprinted with consent of the author and the Association.

3. The public money should be so kept that, while in the treasury of the United States, it will not be withdrawn from the channels of circulation in such a degree as to depress business. When the government locks up its money for a considerable period, large amounts are thus withdrawn from circulation, and a pressure is apt to be brought about in the money market.

4. The public money should be so kept that a surplus in the treasury will not lead to speculation by unduly expanding the currency. The events of 1837–39 have taught us that great care should be exercised to prevent the public moneys from serving as a basis for inflation. If the government entrusts the keeping of its funds to private corporations, it should retain some means of determining to what use they put the public money.

5. The system employed to keep the public treasure should be such that it can be administered without the possibility of favoritism. Politics should not enter into financial administration. The failure to keep politics out of the administration of the public money has caused an endless amount of mischief. From the time Jefferson wrote to Gallatin to make all the banks Republican by depositing the public moneys with them, to the days of Jackson's pet banks, we had more or less partisanship in the management of the public money. Of its disastrous effects we became convinced in 1837. It was found that most of the public money was deposited in the weakest banks — but these were most friendly to the administration.

6. The system of keeping the public money should be inexpensive and convenient. It should work smoothly and facilitate the transaction of public business. Most of the systems employed since 1789 have been on the whole convenient, but some have been much less inexpensive than others. Although no system which fully meets these several requirements has ever been employed in the United States, yet it will be advantageous to consider each of the methods that have been wholly or partly used, and see wherein their chief defects lie.

In the matter of keeping the public money, two general lines of policy may be pursued. The government may consider itself in fiscal matters in a light similar to that in which the individual determines his action concerning the keeping of his money. It may employ agencies already existing — such as transact the

fiscal affairs of individuals, *viz.*, banks and trust companies. This method was in use during the early part of our history. The other line of policy is for the government to separate itself from the moneyed interests of the country, and employ its officers to disburse and keep its funds. This is the method which, since 1846, has been largely employed. It is proposed to consider, first, the advantages and disadvantages of each of these policies of financial administration. Having determined these, an attempt will be made to point out the relative merits and demerits of each particular method which has been employed in the United States.

The advantages of the method of employing fiscal agencies other than governmental appear to be three: 1. It does not draw the money from circulation while in the treasury and thereby tend to contract the currency; 2. It is inexpensive; 3. It is convenient.

It is indispensably necessary for the prosperity of any country that its monetary circulation be not disturbed. In its effect on commerce the circulating medium has been compared to the circulation of the blood in the human body. Nor does it require a vivid imagination to perceive a considerable degree of similarity in the two effects. The evils of a contraction as well as of a sudden expansion of the curreney, *viz.* consequent disturbance of industry and demoralizing effect on all classes of society, need only be mentioned to be understood. Such being the case, in a government where the treasury operations are the largest factor which effects the currency, it is best that, in collecting and disbursing its revenue, the government should not keep any considerable amount of money long locked up in its vaults. By this action a contraction of the currency may be brought on. When the government employs banks to keep its money, it is always certain that the circulation will not be contracted. Though in the government treasury, the money will be loaned as the needs of commerce may require.

An important advantage in the employment of banks as depositories is the consequent inexpensiveness of the administration of the public money. During the years in which either the United States Bank or state banks were depositories, the public money was kept, transmitted, and, to a great extent,

disbursed without cost to the government. This is a very material advantage, as a comprehensive system by which the government keeps and disburses its own money entails a large expense.

A third advantage of the employment of other than government agencies as depositories is the greater convenience which results. The banking interest is more familiar than the government officials with money management of all kinds. Accordingly, when the government officials attempt to manage the public moneys, they are seldom able to bring to their task the skill of the bankers. As a consequence, any method by which a government attempts to have its own officials administer its public money is likely to be more or less clumsy.

The disadvantages of intrusting the public money to private corporations are many and great. In the first place, private corporations serving as depositories of the public money might find it to their interest to enter politics. It is claimed that the first Bank of the United States discriminated in its accommodations according to political bias. Niles charged that no one unless he was a "black cockade federalist" would be accommodated by the Bank. It is said that the second Bank of the United States did not enter politics until its struggle with Jackson, but then there is a very good reason why it did not. There were no party politics during a considerable part of the time from 1817 to 1830. During the era of good feeling party strife was at its lowest ebb, and, of course, the Bank had no occasion to enter into the personal quarrels of individuals, which constituted the only politics of the time. But as soon as political parties again developed, it was impossible for the Bank to remain out of the contest. It had to struggle for its own existence, and accordingly threw its utmost energy into the campaign to defeat Jackson. Benton says the Bank spent over $3,000,000 in influencing editors of newspapers and members of Congress. So it always must be with a giant moneyed corporation acting as the fiscal agent of a government which is a democracy. There will always be in such governments a party opposed to the centralization and combination of capital, and against this party a centralized bank must needs take the field in every severe political contest.

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Again, if the government intrusts the keeping of the public money to a corporation, there is no guarantee that when there is a large surplus on hand, the bank might not be strongly tempted to lower the rate of interest and thus urge excessive loans. This might stimulate the speculative spirit and lead ultimately to a crash. Such a result is likely to happen whether a United States bank, or national, or state banks are the depositories employed. It is not certain that the speculation which resulted in the crash of 1837 would not have occurred if the Bank of the United States had held as large a surplus as the state banks. Even without the government deposits, that bank overissued with the rest, and went down in the general crash. The effect of a large government deposit in the deposit banks at the present time is considered dangerous to our business interests by the *Commercial and Financial Chronicle*. On Nov. 14, 1896, that paper stated that the depository banks held $21,826,241 of government money. Some of the banks which held large amounts were offering money on call at what the *Chronicle* considered dangerously low rates of interest, as they menaced the gold reserve. It accordingly urged the secretary to withdraw somewhat the amounts from the depository banks.

When money is deposited in a bank, it is loaned out, and, when business is booming, the bank is tempted to loan largely and trench upon its reserves to a considerable degree. When the discounts are greatly extended, it is impossible for it to turn its securities at once into cash. In a period of flush times, when all the banks had loaned extensively, and the government suddenly drew for its money, they might not be able to meet its drafts, or their meeting such drafts would compel a refusal of accommodations in discount, thus causing a pressure in the money market and possibly a monetary crisis. This was very clearly shown in the crisis of 1837. At that time the government had more than $26,000,000 on deposit in the banks, which they had loaned out. It made some efforts to secure its money, but as the effect was only to intensify the panic, it was compelled to desist and resort to the issue of treasury notes. In his report for 1882, Secretary Folger said that, singly, the national bank depositories had failed to meet the government's drafts, and

in 1890, Secretary Windom wrote: "The difficulty which the department has encountered during the last year in withdrawing a part of our present bank deposits, even by the careful and conservative methods adopted, and at times when there was no financial pressure, gives some conception of what those difficulties would be in making such withdrawals in times of stringency and commercial distress." If this is the case at the present time, when they are the keepers of only a fraction of the public money, it is probable that the evil would be aggravated were they the exclusive depositories employed. In such a case, the government would be more or less at the mercy of the banks owing to the danger of disturbing the money market by withdrawing its funds. Of course, with the bonds as security, the government could not lose, but it might be put to great inconvenience.

The employment of private corporations as depositories does not preclude the possibility of connivance and corruption in the administration of the public money. Indeed, during the years immediately preceding 1837, the complaints of favoritism were loud and long, and when finally these complaints resulted in an investigation by Congress, it was found that a number of the pet banks had combined and employed an agent at the seat of government, whose business it was to induce the secretary of the treasury to make deposits as large as possible in the institutions of his employers. How well the agent succeeded is clear from the fact that of the eighty-five deposit banks, the nineteen which he represented held three fifths of the public money.

Besides this connivance, it is also clear that the treasury department did not resist the temptation to partisanship in this regard. When the panic of 1837 came, and the suspension rendered the government deposits unavailable, it was found that about two thirds of the public money was on deposit in banks in the Southern and Western states, portions of the country which had given large majorities for the administration. In the banks of the New England states, where the friends of the administration were few, only about one third of the vast surplus was deposited.

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The policy by which the government officials keep the public

money without the assistance of banks has several advantages. In the first place, the money is apt to be safe when the government keeps its own funds. It is true that in the first few years after 1846, when the system was adopted, the provisions of the various depositories were entirely inadequate for the safety of the public money, but that condition has long since passed away. At the present time the probability of loss by the government is practically zero.

By this system also, the money is always under the immediate control of the government. Its drafts can be met promptly. Being separated from the banks in its fiscal affairs, its operations are not apt to be handicapped by bank failures, as was the case in 1837. In the crisis of 1857, the government operations were not interfered with by the panic, and Secretary Cobb wrote that the independent-treasury system of keeping the public money had proved itself eminently successful. When the money is kept in the independent treasury, there is almost no likelihood of its being misappropriated, or illegitimately used in speculation. There is little probability of the government losing control of its funds from this cause, far less than there would be were the money kept in banks whose business it is to loan, and whose reckless extension of discounts might deprive the government of the control of its funds for a considerable period.

Again, by this method, a large surplus can be so managed, as not to encourage speculation. By keeping its surplus revenue in its own vaults, the government is able to prevent the rise of a speculative spirit, which would undoubtedly be encouraged were the surplus deposited in the banks. As long as the policy of surplus financiering is kept up, a reserve should be kept by the government for use in time of emergency. Speaking of putting the government deposits in banks, the *Banker's Magazine* says:[1] "This, however, we believe would be no help at all (for relieving stringencies), for the banks, doubtless, would lend these deposits just as they do others, and, therefore, there would be nothing left, especially for times of stringency. . . . This remedy, therefore, has no merit whatever. What is needed is a reserve somewhere, and for aught we see, the government might just as well keep it as the banks."

1 *Banker's Magazine*, November, 1890.

By this method there is little possibility of party discrimination or favoritism on the part of the officers. Few charges of this kind have ever been made against the independent treasury. It has been pointed out that the secretary has the power to contract or expand the circulation considerably, but during the fifty years that the system has been in operation, he has never been charged with using the power improperly. The publicity of the operations of the treasury, the immense responsibility imposed upon the treasurer and assistant treasurers, and the perpetuity of their bonds, would seem to render speculation on their part extremely improbable.

Aside from its inconvenience and expense, which have already been alluded to, the chief disadvantage of this fiscal policy is that it is likely to disturb the money market. Unless the government makes its payments with considerable frequency, the locking up of its funds in its vaults may result in a stringency. Especially is this true in times of a surplus.

When the policy of surplus financiering is pursued, it is difficult to keep the surplus in the channels of trade. The surplus revenue locked up in the vaults of the treasury is practically as much withdrawn from circulation as though it had been exported. When the surplus accumulations of the government become very large, as in 1888–89–90, they cause serious apprehension to the business interests of the country. In the last of these years, this apprehension, combined with the nervous condition of the money market, resulted in a panic which was somewhat relieved by the expenditure of the surplus in the purchase of bonds. In fact, the purchase of bonds has been the only method resorted to in times of crisis to put the surplus into the channels of trade, and it has been only partially successful. Its failure lies in the fact that it does not allow those who most need the money at such times to secure it.

89. The Methods of Municipalities. — Dr. F. R. Clow gives the following account of the functions of the city officials who are concerned with the details of financial administration :[1]

[1] The Administration of City Finances in the United States. Reprinted with consent of the author and the American Economic Association.

I. The Treasury

When a corporation possesses any money, there must be some one to hold it. This person, in the cities of the United States, is almost universally known as the treasurer. In Baltimore he is called the "register," and in New York he is called the "chamberlain"; Albany and Troy also had chamberlains under their old charters. In the development of government the treasurer is among the first officers to be provided for. The Dongan charter of 1686 provided that the council of New York should elect a chamberlain or treasurer. The town board of Chicago, at its first meeting in 1833, elected a president and treasurer. In 1837, on the granting of the first charter, "the treasury was the first administrative department to be organized." Philadelphia did not have a regular treasurer before 1789; either the mayor or an alderman was appointed treasurer. However, the first ordinance passed under the charter of 1789 was "for ascertaining the duty and pay of the treasurer."

In early times the treasurer was appointed by the council, evidently in accordance with the disposition in the colonies to keep the purse in the hands of the representatives of the people. When the tendency to make all offices elective set in, the treasurer felt the full force of it; but the recent tendency to have officials appointed by the mayor has not included the treasurer. He is now nearly always elected by the popular vote; the exceptions noted are Bangor, Manchester, Baltimore, and several Massachusetts cities where he is appointed by the council, and Boston and New York, where he is appointed by the mayor.

The prevailing term of office of the treasurer, as of all state and local officers, is two years. In New England the cities generally retain the one-year term as they had it when their government centered in the annual town meeting; but in 1897, Boston and New Haven adopted the biennial term. The one-year term also exists in Superior. Philadelphia and Camden have a three-year term; New York, Buffalo, and New Orleans have a four-year term.

The treasurer is uniformly required to give bonds for the faithful performance of his duties, as is often required of other officers; but in his case the bond is very heavy on account of

the large sums of money intrusted to him. The exact amount of the bond, however, seems to be largely a matter of chance or caprice, as it bears no fixed ratio, even approximate, to either the size of the city or the sums usually kept in the treasury.

Formerly the bond was a personal one; that is, it was made up by the friends, chiefly political, of the officers to be bonded, and their reliability had to be passed on by the council or some other officer of the city. But that method of securing the bond is inconvenient and disagreeable to all concerned, is open to great abuses, and is often found insecure. Now the bond is often provided by a surety company for a consideration, and the transaction is a purely business one all around. The business of corporate bonding is of very recent growth, though there is still great room for its extension, especially in the West and South. One who is intimately associated with it, estimated in 1898, that only one tenth of the surety business was carried by corporations. Since then the amount of it has increased about one half.

This development is having highly beneficial results. Real security is afforded where only an appearance of security existed before. But more valuable than this is the improvement in methods of administration, brought about in the same way as fire insurance companies occasion improvements in protection from fires. The officers of the surety companies know the elements of risk and of safety better than legislators or city officers; they proportion the rates somewhat according to the risk, and they refuse to give bond in any case unless certain conditions are complied with; they thus offer a definite pecuniary inducement for the introduction of the best methods of handling city funds.

The most important of these devices to secure safety of the city funds is the requirement that all money received be promptly deposited in banks and that payments be made by checks. This, when combined with a proper accounting system, renders it impossible for the treasurer to steal outright any considerable sum without the aid of the accounting officers or of the bank officials. In Grand Rapids, for example, the council selects a bank in the city to serve as a depository of the city funds. The bank gives a bond for $500,000. It keeps its

account with the city in books provided by the city and open to the inspection of the treasurer, the comptroller, the city attorney, or any member of the council. It must also report monthly to the council stating the amount of money on deposit. The treasurer must deposit daily all money received by him. He receives duplicate receipts for deposits, filing one copy in his own office and the other with the comptroller. Money can be drawn from the depository only on a check signed by the clerk and the comptroller. The surety company requires daily reports of the receipts, the payments, and the amount on deposit. For the loss of money in the depository, the treasurer and his sureties are not held responsible.

In Manchester, to take another example, the treasurer's bond is $60,000. It was formerly personal and was furnished by persons connected with the bank that held the city deposits. In 1898 corporate bonding was introduced; now all the bonds of the city officers are furnished by surety companies, and the cost is paid by the city.

This last feature — the saddling of the cost of the bond upon the city is frequently met with. The regular rate of the premium is 50 cents per $100 per annum. But keen competition between the companies has led to much cutting of rates. The average rate realized on the surety risks in 1900, as given by the Connecticut Insurance Report, was a trifle under 40 cents.

It is not usual to require bonds of banks that hold city deposits, but the numerous losses by failure of banks during the panic of 1893 led to an extension of the practice. The extreme measure of safety seems to be taken in Duluth; there the deposits are distributed among five banks in proportion to their capital, and no bank may receive deposits to exceed one half the amount of its bond.

A little over half of the cities receive interest on their deposits and the proportion is on the increase. Where no interest is received, the custody of the city funds is in danger of becoming one of the political spoils. When a Manchester bank furnished the treasurer's bond, that bank had the city deposits and paid no interest on them. If the treasurer is allowed to keep the money where he pleases, the interest goes into his pocket; in Minneapolis until recently, this was the way in which the treas-

urer was expected to get his salary. If the council decides where the money must be deposited, it goes to banks that enjoy political favor. At one time the People's Bank in Philadelphia, which was controlled by local politicians, had on deposit from $400,000 to $900,000 of city money; the capital stock was only $150,000. In 1882 an ordinance was passed requiring the distribution of the deposits among the banks of the city in proportion to their capital. The city first received interest on its deposits in 1892. It now receives about $75,000 a year from this source. Sometimes the banks unite in a combination and refuse to pay any interest. As the city must deposit its money anyway, they then receive it without interest. Such was recently the situation in Minneapolis and Nashville. The best way to meet such a combination is to deposit as much of the money as possible in banks in other cities; Minneapolis, at the time of the writer's visit in 1898, kept a large deposit in Chicago, and received 2 per cent on it.

City treasurers in California are required by law not to deposit the city funds in banks but to keep them in vaults. The board of education of Superior lost some money in 1893 by the failure of banks and now requires the city treasurer, who holds the funds, to keep them in a safety-deposit box.

It is rare that money in the possession of a city treasurer is lost, and outright stealing by a treasurer is almost unknown. In 1893, Treasurer Haugan of Minneapolis was president of a bank; most of the city money was deposited in his own and one other bank, but he had loaned some city money to private parties without the knowledge of the comptroller. The banks failed and the city lost heavily. The city of Seattle had a series of difficulties with its treasurers, culminating in 1893 in the loss by Treasurer Krug of $120,000 through bank failures and private investments; a portion of this sum was collected from his bondsmen. A more recent embezzlement is that of E. S. Dreyer, treasurer of the West Park board in Chicago, for $310,000; he became insolvent and the money could not be recovered of him. These were all cases in which the treasurer merely intended to use the money temporarily for his own profit, as it was expected he would do, to pay him for his work as treasurer; the trouble arose when his private business became involved.

II. The Department of Accounts

a. The Comptroller

Equally important with the treasurer in a financial system, is the officer who issues orders on the treasurer, and keeps a check on him and a control over all expenditures by a system of accounts. He is variously termed, as is shown by the list in the Appendix. In New England, Virginia, Iowa, Colorado, Utah, California, and Texas he is called the *auditor*. In the other states he is called the *comptroller*, in the largest cities nearly always and frequently in the middle-sized ones, though with the spelling *controller* in Pennsylvania. In the smaller cities the *clerk* performs this function; in Illinois, Kansas, and the South numerous middle-sized cities have no other accounting officer than the clerk; in Minnesota and some other states the clerk is called the *recorder*. Some cities, especially in Missouri, have both comptrollers and auditors. Burlington has three auditors, but the clerk is the real head of the department. Nashville has a comptroller, but he is a subordinate official; the real head of the finance department is the recorder. The two Utah cities, Salt Lake and Ogden, are much similar to Nashville; each has a recorder and an auditor, the latter appearing to be the less important.

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The department of control and accounts runs back to the town clerk and thence, if the mark theory be accepted, to the vestry clerk in England. In town government the selectmen, the supervisor, or the board approve claims and order the payment of money. The paper directing the treasurer to pay money is drawn and signed by the record keeper of the town, known almost everywhere as the clerk, rarely as the recorder. In most cases the clerk still survives in cities as the secretary of the council and the keeper of miscellaneous records.

The department of control is not, like the treasury, early differentiated from administration in general. The Dongan and Montgomery charters of New York left these powers in the hands of the recorder or of the council itself, and there they remained till the office of comptroller was created in 1801.

Philadelphia, as we have seen in the case of the treasurer, was late in differentiating its financial administration; the office of controller was not created till 1854, the duties remaining chiefly with the mayor till then. Baltimore and Chicago did not have comptrollers till 1857, St. Louis till 1877, New Orleans and New Haven till 1897, and Syracuse and Rochester till 1900. But in Massachusetts the importance of a separate department for control and accounts was early recognized. The legislature provided for an auditor in the first city charter it granted, that of Boston in 1822, and has done the same with every charter since then. In other states, however, many examples still exist where the department remains undifferentiated. Such are all cities where the functions of control, audit, and accounts are performed by the clerk or recorder; such also are Sioux Falls, where the auditor is merely the old-fashioned clerk under a new name, and Seattle, where the comptroller is the clerk of the council. In Utah in cities of less than 12,000 inhabitants the recorder is ex officio city auditor. In Burlington and Charleston there is really no accounting department, orders on the treasury being drawn by the mayor.

But some of these cities feel keenly the inconvenience of their system and are striving to remedy it. The mayor of Toledo in a message sent to the council in May, 1894, gives an account of his efforts to have the legislature create the office of comptroller. The city has an auditor, but his duties are purely clerical. The mayor states that the system of accounts is very loose, that the same bills are paid more than once, that officers who collect money do not turn it over to the city treasury, and that some bills are paid without any audit whatever.

One of the largest cities recently struggling with a primitive system of control was Syracuse. The work was divided between the clerk, the council committee on accounts, and an expert accountant hired at the beginning of each year to check the accounts of the preceding year. In his inaugural address in 1896 the mayor spoke of the "urgent necessity of a city auditor or comptroller, who should be appointed to superintend the bookkeeping at the city hall. A competent official is urgently required, with power to make a monthly audit, who would act as a check on departments and committees, and who would

have constantly at hand an accurate statement of the situation in each department." In 1898 at the beginning of his second term he alluded to the same subject again, and said that "no business house would tolerate such antiquated village methods of accounting for a day." As a city of the second class in New York, Syracuse has had a comptroller since Jan. 1, 1900.

New Jersey passed a law in 1880 allowing any city "wherein the office of comptroller does not now exist to create and establish the office." All the cities of New Jersey included in this study now have comptrollers. In Michigan a law permits cities of over 12,000 inhabitants to have a comptroller; in others the clerk is the head of the accounting system.

The term of office of the chief accounting officer is the same as that of the treasurer. The clerk is sometimes elected by the council and sometimes by popular vote. The auditor or comptroller is rarely chosen by the council; most often he is elected by popular vote; but in some of the larger cities he is appointed by the mayor. The National Municipal League recommends election by the council.

b. Auditing Bills

The first function of the department of control is to audit bills against the city. A good statement of the steps which this involves is found in the report of the Manchester auditor for 1895:

1. Is the subject-matter of the bill under examination within the scope of the powers conferred by the legislature on the city government?

2. Is the bill certified by the party legally authorized to make the contract, or cause the expenditure to be made?

3. Has any appropriation been made to meet the expenditures, and is there a balance unexpended sufficient to pay the bill?

4. Are the number of articles in the bill, or the measurements either of dimensions, quantities, or weights correctly and fully stated, and is the proof of the delivery to the city of the whole amount charged sufficient?

5. Is the price charged a fair market price, or is it so largely in excess as to require the attention of the city councils to be called to the same?

6. Is the bill written in a fair, legible hand, correctly cast, and on paper of sufficient length and width to admit of its proper backing and filing?

7. If the bill is in part payment of a contract, the date and total amount

of the contract, the amount already paid, the amount of the work not yet completed, and the per cent retained, if any, should be stated in the bill.

8. Any other inquiries in matters of law and fact which affect the question of indebtedness before the auditor.

9. Approval, rejection, or suspension for further information or correction as the circumstances of each case may require.

Another question might well be inserted in this list: Is the bill one that has not already been paid?

The auditor of Manchester in 1895 thus inspected 5922 bills, besides certifying the pay rolls by which the salaries of regular employees were paid. Not all auditing officers, however, have so high a conception of their duties. In cities below 75,000, such as Toledo, Oshkosh, and Duluth, auditing is often only a clerical process — requiring the bills to be in the proper form and arranging them for consideration by the council.

It may be thought that, as long as the bill has the approval of the department for which the expense was incurred, several of these questions are unnecessary or impertinent, especially the fifth. But if left to the heads of departments, the investigation of any of these points will often be unsatisfactory. The department chief does not make a business of inspecting bills, but he inspects them hastily as they are presented to him in the midst of other work; he is not an expert accountant, and overlooks errors in the computations; the old bills do not remain in his office, and he may have no means except his memory to know whether the prices are right and whether the bill has not already been paid. In all of these respects the auditor is in the most advantageous position.

In the larger cities the auditing officer is clothed with large discretionary powers. The report of the comptroller of New York for 1892 discusses the work of the auditing bureau of that city. The bureau employed eleven men who were charged with the inspection and examination of various works of construction, repair, and maintenance as they progressed, as well as the inspection of materials and supplies delivered to the departments. In 1892 they "made nineteen thousand inspections and examinations, outside of the office, all over the city," and "reported adversely in nearly three thousand cases. In such cases defective works, supplies, and materials were required to

be made good, and compliance with the contracts or agreements was enforced before payment was made of the amounts called for by the vouchers and estimates which had been certified to the finance department by the various departments."

c. Control over Expenditures

The auditor or comptroller is the person who can best perform the duty of keeping the expenditures within the limits set by the budget. To do this he must charge to its proper account, every bill allowed, and keep his books in such a way that he can tell in a moment whether or not there is money available for any bill that may be presented.

But the heads of departments sometimes incur bills in excess of their appropriations, either through ignorance or trusting that the overdraft will be allowed in some way. This involves two evils: it is an unwarranted attempt to force the hand of the government into granting a larger allowance, and it exposes innocent or venturesome claimants to vexation and perhaps loss. The remedy is to push the financial control back to the initial steps that led to the liability — to require that every contract or requisition for supplies shall bear the certificate of the comptroller to the effect that there is a balance appropriated to this purpose sufficient to meet the expense. This device has been generally adopted in the newer charters.

Final responsibility for this control over expenditure may be vested in the council. This is the case in three fourths of the list cities, and probably in nearly all of the smaller cities, of the country that are not mentioned in this study. St. Louis is the largest representative of this class. The twenty-one cities where the council does not have this power are all north of the Ohio and the Potomac, except Jacksonville; Chicago is the farthest west of the number except San Francisco. Massachusetts contains four — Boston, Cambridge, Lowell, and Worcester. Indiana has three — Indianapolis, Ft. Wayne, and Evansville. New York has five — New York, and the cities of the second class, though Rochester and Troy had been in the list when under the old charters. The others not yet mentioned are Baltimore, Cincinnati, Dayton, Erie, Manchester, New

Haven, Philadelphia, and Providence; in the District of Columbia, the expenditure of appropriations is vested in the commissioners.

There is frequently some compromise between the two methods of control. In Grand Rapids claims not recommended by the comptroller are allowed only by a three-fourths vote of all the members of the council. In 1896–97 nine such bills were acted on by the council; eight were not allowed and one was "referred." Chicago, Cincinnati, Erie, and Jacksonville limit executive control to the extent of requiring the approval of the council to formal contracts. Evansville and Worcester do the same with large contracts. On the other hand, Covington allows the department to make expenditures not exceeding $25, without consulting the council; Wheeling sets the limit at $100, and Cleveland at $250. Likewise the payment of regular salaries is often exempted from the action of the council, as in Pittsburg, Columbus, Superior, and Tacoma. Certain departments are excepted, as in Denver. The school board is most often thus favored; the commissions appointed by the governor, or otherwise independent of the rest of the city government, must also have control of the funds of their departments, or their independence is seriously impaired.

It is at once evident that the cities which have the most highly developed budgetary systems are precisely the ones that commit to the comptroller the responsibility for the execution of the budget. The same conditions which make an elaborate budget necessary also render effective control over it by the council impossible. Then the execution of a carefully prepared budget is chiefly ministerial and there is little occasion for the legislative branch to have a part in it; also, — reversing the order of cause and effect, — where the council is done with the finances for a year the moment the budget is passed, there the making of the budget receives the closest attention. If the budget is only a tax levy, of course it does not appropriate at all; the council must make the appropriations later when it approves contracts, orders purchases or work, or allows bills.

But it must not be supposed that, in the multitude of cities where bills must receive the approval of the council, the real work of auditing claims is done there. In a large city it could

not possibly be done by the council or even the ordinary council committee. It goes where all detail work inevitably tends — into executive hands.

d. Checks on Other Departments

Finally the comptroller supervises the accounts of other officers who handle the city's money. He prescribes their forms of account and report, receives reports from them, and inspects their books. But it is over the treasurer that he exercises the most perfect supervision. All bills against the city must receive the approval of the comptroller before being allowed, even when they are allowed in form by the council; all pay rolls and warrants on the treasurer must be signed by him; as also must all checks drawn by the treasurer on the banks acting as depositories. He may keep informed of the money coming into the treasury either by countersigning all receipts given by the treasurer or by inspecting the treasurer's books, or both. In at least two cities, St. Paul and Omaha, the comptroller checks the books of the treasurer daily. Then by occasionally counting the treasurer's cash and receiving statements from the banks of the amount of city money on deposit, the comptroller has a perfect check on the treasurer. In Newark the treasurer informs the comptroller daily of the amount on deposit in the various banks.

Not all cities, however, have a perfect system like this. The most frequent imperfection is that the comptroller has no direct means of knowing how much money comes into the treasury. Sometimes entire departments, like the board of education or the police commission, are independent of the comptroller. Sometimes the treasurer or other officers are allowed to spend or receive petty cash without any check whatever. In 1897 shortages were found in the accounts of three minor officers in Cincinnati, due to the imperfect system of accounting.

CHAPTER XXVII

CENTRAL CONTROL OF LOCAL FINANCE

90. The Growth of State Control in the United States. — Professor John A. Fairlie has written the following account of the centralizing movement in the United States:[1]

Local administration in the United States during the first half of the nineteenth century developed steadily in the direction of a completely decentralized régime. Our constitutional system inevitably made the local authorities subject to the state legislatures; and there was always a large amount of legislative control limiting the scope of local action. But within the limits of powers conferred by the legislature there came to be no administrative supervision over the acts of the local officials.

During the last half century there has been in evidence a counter wave, making its way slowly and with difficulty, and as yet far from overcoming the earlier tide; but nevertheless gaining in force as time goes on. In many branches of administration there have been established state officers and boards with varying powers of inspection and supervision over local officials. This has been the case in the field of health regulation (of which we have just heard), in charity administration, in school management, and in local finance.

It is with the movement toward state administrative supervision in the last named of these fields that this paper is concerned. It is proposed, first to describe what has been accomplished in those states where most has been done; and then to consider the general principles of a wise policy in this matter. What has been done has been mainly in reference to taxation and accounting. What will be said as to a general policy will consider also the question of local indebtedness.

[1] Reprinted, with consent of the author and the Association, from the Proceedings of the American Political Science Association, Vol. I. (1904).

Taxation

Local authorities in this country have only such power of taxation as is conferred by the legislatures. And as yet no local authority in this country has been given power to determine for itself what kind of taxes it should levy, but may levy only those taxes specifically authorized by statutes. There is, therefore, no room for administrative supervision in this direction, since the local authorities have no sphere of independent action.

As to the rate of taxation local discretion is also closely limited. For some taxes, notably the tax or license for the sale of liquors, the state law specifies the rate as well as the nature of the tax. For the general property tax more leeway is given; but on the one hand the local authorities are compelled by statute to levy taxes to meet certain expenditures, and on the other hand are usually restricted as to the aggregate tax rate; and between this Scylla and Charybdis a narrow course must often be steered. Under these circumstances again there is little opportunity for administrative supervision; and none has developed.

When, however, we turn to the assessment of property for the general property tax, we find a wide field for local discretion, and in recent years significant steps in the direction of administrative supervision. Under the methods prevailing in the early part of the nineteenth century, local assessors had complete freedom in the valuation of property, not only for local taxes but also for state taxes. It was in reference to the state taxes that the first step was taken in the direction of administrative supervision. Beginning apparently in Ohio in 1825, state boards of equalization have been established in most states, with power to change the aggregate valuation of counties so as to equalize the apportionment of the state tax. These state boards of equalization differ widely in their organization; but none of them have the necessary means to perform their work satisfactorily. In some states they have been composed only of ex officio members, elected to other positions, and therefore unable to give much attention to their duties in regard to assessments. In several states the boards are composed of a large

number of members, elected in local districts, who give only a small part of their time to this service, — the extreme case being found in Ohio, where it is composed of forty members, who meet once in ten years. In a few states, as New York and California, there is a small number of salaried members, giving most of their time to this work and that of direct assessment; but even in these cases it is impossible for the board to make a complete investigation of the local assessments that would be necessary for an accurate equalization.

Tax commissioners and economists have discussed at length the failures and defects of these boards of equalization. Moreover, they do not come strictly within the subject of this paper; and have been noted simply as the first stage of supervision which paved the way for later centralizing developments. We may, therefore, proceed to consider the latter, considering them in the logical rather than the strictly chronological order.

It may be noted here that these centralizing tendencies in relation to local taxation have been but one aspect of more general changes in the tax laws. And it may be said that it was only after the states had introduced some control over the administration of assessments for state revenue, that the importance and complexity of the work of local assessors and the need for effective supervision over their local duties was understood.

Effective state supervision over local assessing officers seems to have been first established in Indiana. In 1891 there was established in that state a State Board of Tax Commissioners, consisting of two salaried members in addition to the ex officio members of the former State Board of Equalization: to prescribe all forms of books and blanks used in the assessment and collection of taxes; to construe the tax and revenue laws of the state and give instructions to local officers when requested; to see that all assessments of property were made according to law; and to visit each county in the state at least once a year to hear complaints, collect information, and secure compliance with the law. Besides carrying out these mandatory powers, the state tax commissioners have since 1894 called the county assessors of the state to an annual conference.

In 1896 a board of tax commissioners was established in New York with somewhat less authority, including the power to investigate and examine methods of assessment within the state; to furnish local assessors with information to aid them; and to ascertain whether the local assessors faithfully discharged their duties.

A Michigan statute of 1899 provided for a board of tax commissioners with power: to exercise general supervision over the local assessing officers; to confer and advise with them as to their duties; to visit each county in the state once a year, to hear complaints and secure the full assessment of all property in the state. They were also empowered to summon and examine witnesses under oath, to inspect the local assessment rolls, to change the assessment, and to add to the rolls property not assessed.

And a Wisconsin statute of the same year provided for a tax commissioner with two assistants to have general supervision over the system of taxation throughout the state, with specific authority to require reports from local officers. Two years later added powers were conferred: to supervise local assessors and boards of review; to advise and direct local assessing officers, and to initiate proceedings to enforce the laws against negligent or delinquent officials; and to visit the counties and investigate the methods of local assessors. Another statute of 1901 created the new office of county supervisor of assessment, with powers of supervision over town and city assessors.

These administrative measures have not solved all of the difficulties connected with the assessment of property for taxation; but in most of these states they have brought about a decided improvement both in methods and results. Statistical results are less striking in New York than in the other states, partly perhaps because the powers of the state tax commissioners are less, and partly because of the subsequent development of special taxes for state revenues which has apparently caused a relaxation of the supervision of local assessments, now used mainly for local purposes. But in Indiana the assessed valuation of real estate was increased by 44 per cent in one year after the new system went into effect. In Michigan the

assessed valuation of property has increased over 60 per cent from 1899 to 1903. And in Wisconsin where the most thorough system of supervision has been established, local assessments more than doubled in three years. And it may be further noted that in each of these three states the aggregate assessed valuation of property is from 30 to 50 per cent larger than in the neighboring state of Illinois, whose population and wealth are more than double that of the other states, but where there is no efficient system of supervision.

Years before these recent measures for the supervision of local assessors there began the policy in many states of a more complete centralization in the assessment of special classes of property, especially railroads and more recently other transportation companies and also telegraph and telephone companies. In fact only in Rhode Island, New Mexico, and Texas are railroads still assessed by local authorities alone. In some cases this centralization of assessment has been part of the movement to secure such taxes for the state treasury; but in a number of states — notably in Indiana and Illinois since 1872 — the state assessment of such property has been used for purposes of local taxation. Usually this centralized state assessment has been established only for the property of corporations extending over a large number of local taxing districts; but in New York, under a law of 1899, the state tax commissioners assess for local taxation the value of special franchises in the public streets, which are for the most part held by local companies; and in 1901 the Indiana Tax Commission was given charge of the assessment of street and electric railways. The New York Franchise Tax Law has been of great value in drawing attention to a large amount of wealth that had previously escaped taxation; but it may be questioned whether the separation of the franchise from other property elements or the complete centralization in the assessment of distinctly local property is necessary or altogether advisable. In other states the value of such special franchises is now often included (without additional legislation) in the general assessment of the owners in the ordinary course of valuing property for taxation.

Auditing and Accounting

State supervision over local accounts is as yet less developed than state supervision over local assessments. This is perhaps not surprising in view of the fact that in most states the accounts of state finances are very far from satisfactory. It is true there have been state auditors and comptrollers since the establishment of state governments — and in some cases similar officers in colonial times. But the functions of such officers have often been limited; while primitive methods of bookkeeping, established in the days of insignificant financial transactions, have remained in use after expenditures have come to be counted in millions of dollars, and in the face of the development of systematic accounting in private and corporate business. Indeed, the imperfect and inadequate accounting methods of the larger cities have often been somewhat better than those of the states within which the cities are located.

But within recent years there have been significant measures taken both to establish satisfactory accounting systems for the state finances, and also to establish state supervision over the accounts of local officers. It is only the latter part of this development that can be here considered.

Massachusetts seems to have been the first state to have undertaken any effective control over local accounts. And here the supervision has been confined to officers of the counties, which in that state have never developed any vigorous local autonomy. Thus appropriations and tax levies for each county except Suffolk have long been voted by the legislature, although this is largely a matter of form and the estimates and proposals of the county commissioners are regularly adopted. In 1879, however, the commissioners of savings banks were authorized and required to inspect the books and accounts of most of the county officers, with power to require uniformity in methods of keeping accounts and financial reports in accordance with prescribed forms. In 1887 the state supervision was made more effective by placing it in the hands of a newly established office of controller of county accounts, whose duties included the accounts of some officers previously exempted.

Valuable results have come from this supervision of county

accounts. Irresponsible methods disclosed in the '70's have been corrected; and important reforms have been introduced. Governor Bates two years ago testified to the good that has been derived from the uniform system of accounting established in the counties; and indorsed a similar supervision over municipal accounts.

One of the youngest states in the far West was the next to follow up these partial measures of the old Puritan commonwealth, by establishing a comprehensive system of state supervision over local accounts. The constitution of Wyoming, adopted in 1890, provided for the office of state examiner to examine the accounts of certain state officers, clerks of courts, county treasurers, and such other duties as the legislature might prescribe. This was followed by the enactment of statutes, which before long placed under the supervision of this officer the accounts of every public officer in the state handling public funds; authorized him to establish a uniform system of bookkeeping by the state and local officials, and to examine their accounts; and made provisions for further action in cases of defalcation discovered through his examinations. The same officer has also supervision over banks and other private financial institutions.

The examination of public accounts is technical and embraces the checking of every item whether great or small, the subsequent footing of the cash accounts, and finally their summation. Every account paid is closely examined, the nature of the expense ascertained, the legality of the bill inquired into, and the amount is finally checked to the stub of the warrant issued, and also entered in the proper column of the expense register. Whether or not the officer conducted the affairs of his office in conformity with the statute is also made a subject of inquiry.

The examination made, a written report setting forth the results accompanied with criticisms, requirements, and recommendations is prepared and filed with the governor, and a copy thereof filed with the officer or officers whose accounts were the subject of investigation. Should it appear that there had been violations of law in the conduct of any office, the examiner must report thereon, and he has authority to enforce his rulings. In case of defalcation or embezzlement, his findings are absolute, until reversed by the district or other court having jurisdiction.

In case of the default of any treasurer and the inability of such officer to replace funds illegally used within the time designated by the examiner, the examiner shall at once assume charge and in all respects he becomes the

legally constituted treasurer of the state, county, municipality, or school district, as the case may be.

Another important feature is the meeting of the examiner with the constituted boards authorized to make the annual tax levy. At such time the expense budget for the ensuing year is carefully canvassed and reductions made wherever possible. This paves the way for a reduced levy of taxes, and frequently the total levy may be reduced from one fourth to one mill or more as compared with the previous year.

Striking evidence may be adduced of the benefits resulting from this system of supervision in Wyoming. In 1892 the expenditures of the twelve counties in the state were $412,000, while only two counties were on an approximate cash basis, the others generally allowing their expenses to exceed their revenues and issuing illegal warrants to pay bills. In 1899, with thirteen counties, the total expenditures had been reduced to $295,000; and every county was on a cash basis with a surplus at the end of the year. Several governors of the state have specially commended the work of the state examiner in their messages to the state legislature.

Other states near Wyoming soon followed its example to some extent. Montana and North Dakota have each created the office of state examiner, with power to examine books and prescribe accounting methods in county offices, as well as state institutions. South Dakota, Nebraska, and Kansas have provided a less effective supervision, — in the two first named through the state auditor; in the last named through a state accountant. More recently (in 1903) Nevada has established a more intensive system of control. A State Board of Revenue must approve the debts of local governments, prescribe the forms for financial reports to the state comptroller, and employ an examiner to inspect the accounts and records. And in the same year the extreme southern state of Florida created the office of state auditor, whose chief duty is to prescribe the form of county accounts and see by inspection that they are properly kept.

In the state of New York something has been accomplished in the same direction. Beginning in 1892 the state comptroller has been given power to audit certain accounts of county treasurers, including the court and trust funds and the accounts

for the inheritance tax; while the state excise commissioner has similar authority over the accounts for the liquor tax. The introduction of the comptroller's audit disclosed inextricable confusion in the various accounts of county treasurers, and that within a few years before there had been defalcations or shortages in thirty-three of the sixty counties in the state. A uniform system of bookkeeping has now been introduced for these special funds, which with the regular audit discovers and often prevents deficits and defalcations.

In 1903 a statute was enacted requiring all cities in the state with less than 250,000 population to make uniform financial reports to the secretary of state. But as no provision was made for uniformity of accounts or for an examination or audit of the books of the city officers nothing has as yet been accomplished under this provision.

Until two years ago this movement toward state supervision of local accounts was confined to the less important states and to such partial measures in the larger states as have been noted. But in 1902 the state of Ohio enacted the most important law on the subject yet adopted. This provided for a uniform system of accounting, auditing, and reporting for every public office in that state, under the supervision of a newly established bureau of inspection in the office of the auditor of state. The act requires separate accounts for every appropriation or fund, and for every department, institution, public improvement, or public service industry; provides for full financial reports to the auditor of state; and authorizes annual examinations of the finances of all public offices, with power to the examiners to subpœna witnesses and examine them under oath.

To carry out the provisions of the act three deputies and a clerk were appointed by the auditor of state, all of whom were former county auditors and experienced in local methods. These, with the assistance of expert accountants who had given special attention to municipal accounting, and after a thorough investigation of existing practices, prepared complete systems of accounting which have been installed throughout the state in the offices of county auditors and treasurers, city auditors and treasurers, village clerks and treasurers, school district clerks and treasurers, and township clerks and treasurers. The first

examinations of the accounts are now being made by the examiners of the bureau; and from their reports comparative statistics of local finances covering the whole state of Ohio will be published.

This brief description of these various measures must bring into clearer light their significance and a tendency which they illustrate. No one considered by itself, nor even all that has been done in any single state, may seem of very large importance. But when the detached and apparently disconnected pieces have been brought together, it must be evident that in the aggregate they indicate a distinct movement toward state supervision of local finance. We may, therefore, inquire into the rationale of such a movement, and consider to what extent it should be encouraged.

In some respects the movement may seem in conflict with general principles which are still declared to be fundamental in our American system of government. It must be admitted at least that it is not consistent with the most extreme demands for local autonomy; and that state control is not so clearly justified in this field by a general state interest, as is the case in state supervision of health administration, schools, or the local management of state finances.

If, however, instead of unreasoned ideas, we apply the principles of such political thinkers as John Stuart Mill and Henry Sidgwick, it will be seen that this movement is in entire accord with a rational political philosophy. These writers recognize fully the advantages of locally elected authorities for matters of local interest, as well as for the sake of the political education of the people. But they also point out the advantages of central supervision, not only where the interests of the larger governmental units are directly concerned, but also because of the more complete information and the larger degree of technical efficiency which the higher government can command.[1]

Both of these latter factors support state supervision in the two branches of local finance that have been noted. The assessment of property with any approach to equality of treat-

[1] Mill, Representative Government, ch. 15; Sidgwick, Elements of Politics, ch. 25.

ment calls for a high degree of expert skill, and the comparison of conditions over a wide area. A uniform system of accounting is essential for accurate information on public expenditures, and for the comparison of outlay with returns in the many branches of local administration. And state control over the accounts of local public authorities is certainly as important as the control that has been established in most states over the accounts of private corporations, such as railroads, banks, and insurance companies. It may also be noted that the state supervision established over local finance does not restrict local management where local control is essential, — in determining the amount and distribution of expenditures.

In conclusion attention may be called to another branch of local finance where a system of state administrative supervision is urgently needed, — over the loans and debts of local authorities. The need for some control here is already recognized in the constitutional and statutory debt limits established. But these arbitrary limits do not and cannot adjust themselves to the varying needs and conditions of different local communities. There is a great difference between a debt incurred for waterworks, which will be met by the revenue from the undertaking, and a debt for parks which must be paid from general taxation, and a debt for street paving that may be worn out in ten years. To decide whether additional debt may be safely incurred can be determined wisely only after a careful examination of a complex financial situation, involving a study, not merely of the aggregate amount of existing debt, but also of the provisions for meeting this debt and of the resources of the local government concerned. Such an examination requires expert technical knowledge, which is entirely absent from the present crude legislative limitations, and can only be supplied by a permanent administrative authority.

STATISTICAL APPENDIX

I

RECEIPTS AND EXPENDITURES OF THE UNITED STATES IN 1904

The revenues of the government from all sources (by warrants) for the fiscal year ended June 30, 1904, were: —

From customs	$261,274,564.81
From internal revenue	232,904,119.45
From sales of public lands	7,453,479.72
From profits on coinage, bullion deposits, etc.	6,373,396.28
From revenues of the District of Columbia	5,454,344.47
From fees — consular, letters patent, and lands	4,202,730.39
From sales of Indian lands, proceeds of Indian labor, etc.	3,112,720.76
From navy pension, navy hospital, clothing, and deposit funds	2,570,073.56
From tax on circulation of national banks	1,836,639.49
From payment of interest by Pacific railways	1,782,468.97
From trust funds, Department of State	1,791,741.25
From immigrant fund	1,662,835.01
From customs and navigation fees, fines, penalties, etc.	831,572.41
From miscellaneous	731,654.64
From Soldiers' Home permanent fund	687,653.49
From sales of government property	547,774.22
From judicial fees, fines, penalties, etc.	407,252.71
From sale of lands, buildings, etc.	252,549.18
From deposits for surveying public lands	205,757.33
From tax on sealskins	197,200.70
From reimbursement of loan to Louisiana Purchase Exposition Company	195,057.04
From license fees, Territory of Alaska	168,975.43
From sales of ordnance material	129,843.06
From depredations on public lands	101,128.59
From Spanish indemnity	57,000.00
From part payment Central Pacific Railroad indebtedness	5,699,156.44
	$540,631,749.40
From postal revenues	143,582,624.34
Total receipts	$684,214,373.74

The expenditures for the same period were: —

For the civil establishment, including foreign intercourse, public buildings, Panama Canal, collecting the revenues, District of Columbia, and other miscellaneous expenses	$180,264,172.06
For the military establishment, including rivers and harbors, forts, arsenals, seacoast defenses, and expenses of the war with Spain and in the Philippines	115,035,410.58
For the naval establishment, including construction of new vessels, machinery, armament, equipment, improvement at navy yards, and expenses of the war with Spain and in the Philippines .	102,956,101.55
For Indian Service	10,438,350.09
For pensions	142,559,266.36
For interest on the public debt	24,646,489.81
For deficiency in postal revenues	6,502,530.86
	$582,402,321.31
For postal service	143,582,624.34
Total expenditures	$725,984,945.65
Showing a deficit of	$41,770,571.91

The sum of $50,000,000 was paid during the year for the right of way of the Panama Canal.

II

RECEIPTS AND EXPENDITURES OF THE UNITED STATES FROM 1856 TO 1905

A. RECEIPTS (,000 omitted)

YEAR	CUSTOMS	INTERNAL REVENUE	DIRECT TAX	SALES OF PUBLIC LANDS	PREMIUMS ON LOANS AND SALES OF GOLD COIN	MISCELLANEOUS	TOTAL REVENUE	EXCESS OF REVENUE OVER EXPENDITURES
1856 . .	$64,022	—	—	$8,917	—	$1,116	$74,056	$4,485
1857 . .	63,875	—	—	3,829	—	1,259	68,965	1,169
1858 . .	41,789	—	—	3,513	—	1,352	46,655	27,529[1]
1859 . .	49,565	—	—	1,756	$709	1,454	53,486	15,584[1]
1860 . .	53,187	—	—	1,778	10	1,088	56,064	7,065[1]
1861 . .	39,582	—	—	870	33	1,023	41,509	25,036[1]
1862 . .	49,056	—	$1,795	152	68	915	51,987	422,774[1]
1863 . .	69,059	$37,640	1,485	167	602	3,741	112,697	602,043[1]
1864 . .	102,316	109,741	475	588	21,174	30,331	264,626	600,695[1]
1865 . .	84,928	209,464	1,200	996	11,683	25,441	333,714	963,840[1]
1866 . .	179,046	309,226	1,974	665	38,083	29,036	558,032	37,223
1867 . .	176,417	266,027	4,200	1,163	27,787	15,037	490,634	133,091
1868 . .	164,464	191,087	1,788	1,348	29,203	17,745	405,638	28,297
1869 . .	180,048	158,356	765	4,020	13,755	13,997	370,943	48,078
1870 . .	194,538	184,899	229	3,350	15,295	12,942	411,255	101,601
1871 . .	206,270	143,098	580	2,388	8,892	22,093	383,323	91,146
1872 . .	216,370	130,642	—	2,575	9,412	15,106	374,106	96,588
1873 . .	188,089	113,729	315	2,882	11,560	17,161	333,738	43,392
1874 . .	163,103	102,409	—	1,852	5,037	17,075	289,478	2,344
1875 . .	157,167	110,007	—	1,413	3,979	15,431	288,000	13,376
1876 . .	148,071	116,700	93	1,129	4,029	17,456	287,482	29,022
1877 . .	130,956	118,630	—	976	405	18,031	269,000	30,340
1878 . .	130,170	110,581	—	1,079	317	15,614	257,763	20,799
1879 . .	137,250	113,561	—	924	1,505	20,585	273,827	6,879
1880 . .	186,522	124,009	—	1,016	—	21,978	333,526	65,883
1881 . .	198,159	135,264	1	2,201	—	25,154	360,782	100,069
1882 . .	220,410	146,497	160	4,753	—	31,703	403,525	145,543
1883 . .	214,706	144,720	108	7,955	—	30,796	398,287	132,879
1884 . .	195,067	121,586	70	9,810	—	21,984	348,519	104,393
1885 . .	181,471	112,498	—	5,705	—	24,014	323,690	63,463
1886 . .	192,905	116,805	108	5,630	—	20,989	336,439	93,956
1887 . .	217,286	118,823	32	9,254	—	26,005	371,403	103,471
1888 . .	219,091	124,296	1	11,202	—	24,674	379,266	111,341
1889 . .	223,832	130,881	—	8,038	—	24,297	387,050	87,761
1890 . .	229,668	142,606	—	6,358	—	24,447	403,080	85,040
1891 . .	219,522	145,686	—	4,029	—	23,374	392,612	26,838
1892 . .	177,452	153,971	—	3,261	—	20,251	354,937	9,914
1893 . .	203,355	161,027	—	3,182	—	18,254	385,819	2,341
1894 . .	131,818	147,111	—	1,673	—	17,118	297,722	69,803[1]
1895 . .	152,158	143,421	—	1,103	—	16,706	313,390	42,805[1]
1896 . .	160,021	146,762	—	1,005	—	19,186	326,976	25,203[1]
1897 . .	176,554	146,688	—	864	—	23,614	347,721	18,052[1]
1898 . .	149,575	170,900	—	1,243	—	83,602	405,321	38,047[1]
1899 . .	206,128	273,437	—	1,678	—	34,716	515,960	89,111[1]
1900 . .	233,164	295,327	—	2,836	—	35,911	567,240	79,527
1901 . .	238,585	307,180	—	2,965	—	38,954	587,685	77,717
1902 . .	254,444	271,880	—	4,144	—	32,009	562,478	91,287
1903 . .	284,479	230,810	—	8,926	—	36,180	560,396	54,297
1904 . .	261,274	232,904	—	7,453	—	38,999	540,631	41,770[1]
1905 . .	261,798	234,095	—	4,859	—	43,520	544,274	23,004[1]

[1] Expenditures in excess of revenue.

TABLE II (*Continued*)

B. Expenditures (,000 omitted)

Year	Premiums on Bonds Purchased, etc.	Civil and Miscellaneous	War Department	Navy Department	Indians	Pensions	Interest on Public Debt	Total Expenditures
1856 . .	$385	$32,124	$16,948	$14,091	$2,769	$1,298	$1,953	$69,571
1857 . .	363	28,164	19,261	12,747	4,267	1,312	1,678	67,795
1858 . .	574	26,429	25,485	13,984	4,926	1,217	1,567	74,185
1859 . .	—	23,700	23,243	14,642	3,625	1,220	2,638	69,070
1860 . .	—	27,976	16,409	11,514	2,949	1,102	3,177	63,130
1861 . .	—	23,267	22,981	12,420	2,841	1,036	4,000	66,546
1862 . .	—	21,408	394,368	42,668	2,273	853	13,190	474,761
1863 . .	—	23,256	599,298	63,221	3,154	1,078	24,729	714,740
1864 . .	—	27,505	690,791	85,725	2,629	4,983	53,685	865,322
1865 . .	1,717	43,047	1,031,323	122,612	5,116	16,338	77,397	1,297,555
1866 . .	58	41,056	284,449	43,324	3,247	15,605	133,067	520,809
1867 . .	10,813	51,110	95,224	31,034	4,642	20,936	143,781	357,542
1868 . .	7,001	53,009	123,246	25,775	4,100	23,782	140,424	377,340
1869 . .	1,674	56,474	78,501	20,000	7,042	28,476	130,694	322,865
1870 . .	15,996	53,237	57,655	21,780	3,407	28,340	129,235	309,653
1871 . .	9,016	60,481	35,799	19,431	7,426	34,443	125,576	292,177
1872 . .	6,958	60,984	35,372	21,249	7,061	28,533	117,357	277,517
1873 . .	5,105	73,328	46,323	23,526	7,951	29,359	104,750	290,345
1874 . .	1,395	69,641	42,313	30,932	6,692	29,038	107,119	287,133
1875 . .	—	71,070	41,120	21,497	8,384	29,456	103,093	274,623
1876 . .	—	66,958	38,070	18,963	5,966	28,257	100,243	258,459
1877 . .	—	56,252	37,082	14,959	5,277	27,963	97,124	238,660
1878 . .	—	53,177	32,154	17,365	4,629	27,137	102,500	236,964
1879 . .	—	65,741	40,425	15,125	5,206	35,121	105,327	266,947
1880 . .	2,795	54,713	38,116	13,536	5,945	56,777	95,757	267,642
1881 . .	1,061	64,416	40,466	15,686	6,514	50,059	82,508	260,712
1882 . .	—	57,219	43,570	15,032	9,736	61,345	71,077	257,981
1883 . .	—	68,678	48,911	15,283	7,362	66,012	59,160	265,408
1884 . .	—	70,920	39,429	17,292	6,475	55,429	54,578	244,126
1885 . .	—	87,494	42,670	16,021	6,552	56,102	51,386	260,226
1886 . .	—	74,166	34 324	13,907	6,099	63,404	50,580	242,483
1887 . .	—	85,264	38,561	15,141	6,194	75,029	47,741	267,932
1888 . .	8,270	72,952	38,522	16,926	6,249	80,288	44,715	267,924
1889 . .	17,292	80,664	44,435	21,378	6,892	87,624	41,001	299,288
1890 . .	20,304	81,403	44,582	22,006	6,708	106,936	36,099	318,040
1891 . .	10,401	110,048	48,720	26,113	8,527	124,415	37,547	365,773
1892 . .	—	99,841	46,895	29,174	11,150	134,583	23,378	345,023
1893 . .	—	103,732	49,641	30,136	13,345	159,357	27,264	383,477
1894 . .	—	101,943	54,567	31,701	10,293	141,177	27,841	367,525
1895 . .	—	93,279	51,804	28,797	9,939	141,395	30,978	356,195
1896 . .	—	87,216	50,830	27,147	12,165	139,434	35,385	352,179
1897 . .	—	90,401	48,950	34,561	13,016	141,053	37,791	365,774
1898 . .	—	96,520	91,992	58,823	10,994	147,452	37,585	443,368
1899 . .	—	119,191	229,841	63,942	12,805	139,394	39,896	605,072
1900 . .	—	105,773	134,774	55,953	10,175	140,877	40,160	487,713
1901 . .	—	122,282	144,615	60,506	10,896	139,323	32,342	509,967
1902 . .	—	113,469	112,272	67,803	10,049	138,488	29,108	471,190
1903 . .	—	124,944	118,619	82,618	12,935	138,425	28,556	506,099
1904 . .	—	186,766	115,035	102,956	10,438	142,559	24,646	582,402
1905 . .	—	146,952	122,175	117,550	14,236	141,773	24,590	567,278

III

INTERNAL REVENUE RECEIPTS FROM THE VARIOUS SOURCES (1863–1904)

(,000 omitted)

Year ending June 30	Spirits	Tobacco	Fermented Liquors	Oleomargarine	Special Taxes not elsewhere Enumerated	Legacies and Distributive Shares of Personal Property	Stamp Taxes	Playing Cards	Penalties, Etc.	Articles and Industries formerly Taxed, but now Exempt, and Miscellaneous	Total
1863	$5,176	$3,097	$1,628	—	—	—	—	—	$27	$31,072	$41,003
1864	30,329	8,592	2,290	—	—	—	—	—	193	75,740	117,145
1865	18,731	11,401	3,734	—	—	—	—	—	520	176,741	211,129
1866	33,268	16,531	5,220	—	—	—	—	—	1,142	254,744	310,906
1867	33,542	19,765	6,057	—	—	—	—	—	1,459	205,095	265,920
1868	18,655	18,730	5,955	—	—	—	—	—	1,256	146,582	191,180
1869	45,071	23,430	6,099	—	—	—	—	—	877	84,560	160,039
1870	55,606	31,350	6,319	—	—	—	—	—	827	91,132	185,235
1871	46,281	33,578	7,389	—	—	—	—	—	636	56,123	144,011
1872	49,475	33,736	8,258	—	—	—	—	—	442	39,858	131,770
1873	52,099	34,386	9,324	—	—	—	—	—	461	17,803	114,075
1874	49,444	33,242	9,304	—	—	—	—	—	364	10,288	102,644
1875	52,081	37,303	9,144	—	—	—	—	—	281	11,734	110,545
1876	56,426	39,795	9,571	—	—	—	—	—	409	11,034	117,237
1877	57,469	41,106	9,480	—	—	—	—	—	419	10,518	118,995
1878	50,420	40,091	9,937	—	—	—	—	—	346	10,302	111,097
1879	52,570	40,135	10,729	—	—	—	—	—	279	10,204	113,918
1880	61,185	38,870	12,829	—	—	—	—	—	383	11,247	124,516
1881	67,153	42,854	13,700	—	—	—	—	—	231	11,839	135,779
1882	69,873	47,391	16,153	—	—	—	—	—	199	13,474	147,093

TABLE III (*Continued*)

Year ending June 30	Spirits	Tobacco	Fermented Liquors	Oleomargarine	Special Taxes not elsewhere Enumerated	Legacies and Distributive Shares of Personal Property	Stamp Taxes	Playing Cards	Penalties, Etc.	Articles and Industries formerly Taxed, but now Exempt, and Miscellaneous	Total
1883	$74,368	$42,104	$16,900	—	—	—	—	—	$305	$11,479	$145,158
1884	76,905	26,062	18,084	—	—	—	—	—	289	265	121,607
1885	67,511	26,407	18,230	—	—	—	—	—	222	49	112,421
1886	69,092	27,907	19,676	—	—	—	—	—	194	32	116,902
1887	65,829	30,108	21,922	$723	—	—	—	—	220	33	118,837
1888	69,306	30,662	23,324	864	—	—	—	—	155	13	124,326
1889	74,312	31,866	23,723	894	—	—	—	—	84	12	130,894
1890	81,687	33,958	26,008	786	—	—	—	—	136	16	142,594
1891	83,335	32,796	28,565	1,077	—	—	—	—	256	3	146,035
1892	91,309	31,000	30,037	1,266	—	—	—	—	240	2	153,857
1893	94,720	31,889	32,548	1,670	—	—	—	—	168	6	161,004
1894	85,259	28,617	31,414	1,723	—	—	—	—	151	1	147,168
1895	79,862	29,704	31,640	1,409	—	—	—	$382	168	77	143,246
1896	80,670	30,711	33,784	1,219	—	—	—	259	184	—	146,830
1897	82,008	30,710	32,472	1,034	—	—	—	251	134	9	146,619
1898	92,547	36,230	39,515	1,315	$46	—	$794	261	153	2	170,866
1899	99,283	52,493	68,644	1,956	4,921	$1,235	43,837	271	184	656	273,484
1900	109,868	59,355	73,550	2,543	4,515	2,884	40,964	331	210	1,091 [1]	295,316
1901	116,027	62,481	75,669	2,518	4,165	5,211	39,241	317	200	1,037 [2]	306,871
1902	121,138	51,937	71,988	2,944	4,262	4,842	13,442	364	208	737 [3]	271,867
1903	131,953	43,514	47,547	736	—	—	—	422	148	6,417 [4]	230,740
1904	135,810	44,655	49,083	484	—	—	—	376	206	2,287 [5]	232,904

[1] Includes $1,079,405 from excise tax. [2] Includes $1,027,295 from excise tax. [3] Includes $730,376 from excise tax.

[4] Includes $6,445.26 from filled cheese, $1,795.50 from mixed flour, $151,558.97 from process or renovated butter, and $5,356,774.90 from legacies on which the tax had accrued prior to the repeal of the act.

[5] Includes $3,543.23 from filled cheese, $1,565.58 from mixed flour, $1,915.90 from adulterated butter, $140,873.53 from process or renovated butter, $100 from opium, and $2,072,132.12 from legacies on which the tax had accrued prior to the repeal of the act.

IV

THE PUBLIC DEBT OF THE UNITED STATES

(*A*) Principal of Debt outstanding each Year from 1791 to 1904

(,000 omitted)

Year beginning Jan. 1	Amount	Year beginning Jan. 1	Amount	Year beginning July 1	Amount	Year beginning July 1	Amount
1791	$75,463	1822	$93,546	1843	$32,742	1874	$2,251,690[1]
1792	77,227	1823	90,875	1844	23,461	1875	2,232,284[1]
1793	80,358	1824	90,269	1845	15,925	1876	2,180,395[1]
1794	78,427	1825	83,788	1846	15,550	1877	2,205,301[1]
1795	80,747	1826	81,054	1847	38,826	1878	2,256,205[1]
1796	83,762	1827	73,987	1848	47,044	1879	2,349,567[1]
1797	82,064	1828	67,475	1849	63,061	1880	2,120,415[1]
1798	79,228	1829	58,421	1850	63,452	1881	2,069,013[1]
1799	78,408	1830	48,565	1851	68,304	1882	1,918,312[1]
1800	82,976	1831	39,123	1852	66,199	1883	1,884,171[1]
1801	83,038	1832	24,322	1853	59,803	1884	1,830,528[1]
1802	80,712	1833	7,001	1854	42,242	1885	1,876,424[2]
1803	77,054	1834	4,760	1855	35,586	1886	1,756,445[2]
1804	86,427	1835	33	1856	31,932	1887	1,688,229[2]
1805	82,312	1836	37	1857	28,699	1888	1,705,992[2]
1806	75,723	1837	336	1858	44,911	1889	1,640,673[2]
1807	69,218	1838	3,308	1859	58,496	1890	1,585,821[2]
1808	65,196	1839	10,434	1860	64,842	1891	1,560,472[2]
1809	57,023	1840	3,573	1861	90,580	1892	1,628,840[2]
1810	53,173	1841	5,250	1862	524,176	1893	1,598,111[2]
1811	48,005	1842	13,594	1863	1,119,772	1894	1,668,757[2]
1812	45,209	1843	20,201	1864	1,815,784	1895	1,698,676[2]
1813	55,962			1865	2,680,647	1896	1,778,434[2]
1814	81,487			1866	2,773,236	1897	1,811,435[2]
1815	99,833			1867	2,678,126	1898	1,798,066[2]
1816	127,334			1868	2,611,687	1899	1,984,766[2]
1817	123,491			1869	2,588,452	1900	2,101,445[2]
1818	103,466			1870	2,480,672	1901	2,094,481[2]
1819	95,529			1871	2,353,211	1902	2,111,654[3]
1820	91,015			1872	2,253,251	1903	2,162,639[3]
1821	89,987			1873	2,234,482[1]	1904	2,226,571[3]

[1] In the amount here stated as the outstanding principal of the public debt are included the certificates of deposit outstanding on the 30th of June, issued under act of June 8, 1872, for which a like amount in United States notes was on special deposit in the Treasury for their redemption and added to the cash balance in the Treasury. These certificates, as a matter of accounts, are treated as a part of the public debt, but being offset by notes held on deposit for their redemption, should properly be deducted from the principal of the public debt in making comparison with former years.

[2] Exclusive of gold, silver, currency certificates, and Treasury notes of 1890 held in the Treasurer's cash, and including bonds issued to the several Pacific railroads not yet redeemed.

[3] Exclusive of gold and silver certificates and Treasury notes of 1890 held in the Treasurer's cash.

TABLE IV (*Continued*)

(*B*) ANALYSIS OF THE TOTAL DEBT OUTSTANDING EACH YEAR FROM 1856 TO 1904
(,000 omitted)

YEAR BEGINNING JULY 1	DEBT ON WHICH INTEREST HAS CEASED	DEBT BEARING NO INTEREST	OUT-STANDING PRINCIPAL	CASH IN THE TREASURY, JULY 1	TOTAL DEBT LESS CASH IN TREASURY	ANNUAL INTEREST CHARGE
1856 . . .	$209	—	$31,972	$21,006	$10,965	$1,869
1857 . . .	238	—	28,699	18,701	9,998	1,672
1858 . . .	211	—	44,911	7,011	37,900	2,446
1859 . . .	206	—	58,496	5,091	53,405	3,126
1860 . . .	201	—	64,842	4,877	59,964	3,443
1861 . . .	199	—	90,580	2,862	87,718	5,092
1862 . . .	280	$158,591	524,176	18,863	505,312	22,048
1863 . . .	473	411,767	1,119,772	8,421	1,111,350	41,854
1864 . . .	416	455,437	1,815,784	106,332	1,709,452	78,853
1865 . . .	1,245	458,090	2,680,647	5,832	2,674,815	137,742
1866 . . .	935	439,969	2,773,236	137,200	2,636,036	146,068
1867 . . .	1,840	428,218	2,678,126	169,974	2,508,151	138,892
1868 . . .	1,197	408,401	2,611,687	130,834	2,480,853	128,459
1869 . . .	5,260	421,131	2,588,452	155,680	2,432,771	125,523
1870 . . .	3,708	430,508	2,480,672	149,502	2,331,169	118,784
1871 . . .	1,948	416,565	2,353,211	106,217	2,246,994	111,949
1872 . . .	7,926	430,530	2,253,251	103,470	2,149,780	103,988
1873 . . .	51,929	472,069	2,234,482	129,020	2,105,462	98,049
1874 . . .	3,216	509,543	2,251,690	147,541	2,104,149	98,796
1875 . . .	11,425	498,182	2,232,284	142,243	2,090,041	96,855
1876 . . .	3,902	465,807	2,180,395	119,469	2,060,925	96,104
1877 . . .	16,648	476,764	2,205,301	186,025	2,019,275	93,160
1878 . . .	5,594	455,875	2,256,205	256,823	1,999,382	94,654
1879 . . .	37,015	410,835	2,245,495	249,080	1,996,414	83,773
1880 . . .	7,621	388,800	2,120,415	201,088	1,919,326	79,633
1881 . . .	6,723	422,721	2,069,013	249,363	1,819,650	75,018
1882 . . .	16,260	438,241	1,918,312	243,289	1,675,023	57,360
1883 . . .	7,831	538,111	1,884,171	345,389	1,538,781	51,436
1884 . . .	19,656	584,308	1,830,528	391,985	1,438,542	47,926
1885 . . .	4,100	663,712	1,863,964	488,612	1,375,352	47,014
1886 . . .	9,704	619,344	1,775,063	492,917	1,282,145	45,510
1887 . . .	6,115	629,795	1,657,602	482,433	1,175,168	41,780
1888 . . .	2,496	739,840	1,692,858	629,854	1,063,004	38,991
1889 . . .	1,911	787,287	1,619,052	643,113	975,939	33,752
1890 . . .	1,815	825,011	1,552,140	661,355	890,784	29,417
1891 . . .	1,614	933,852	1,545,996	694,083	851,912	23,615
1892 . . .	2,785	1,000,648	1,588,464	746,937	841,526	22,893
1893 . . .	2,094	958,854	1,545,985	707,016	838,969	22,894
1894 . . .	1,851	995,360	1,632,253	732,940	899,313	25,394
1895 . . .	1,721	958,197	1,676,120	774,448	901,672	29,140
1896 . . .	1,636	920,839	1,769,840	814,543	955,297	34,387
1897 . . .	1,346	968,960	1,817,672	831,016	986,656	34,387
1898 . . .	1,262	947,901	1,796,531	769,446	1,027,085	34,387
1899 . . .	1,218	944,660	1,991,927	836,607	1,155,320	40,347
1900 . . .	1,176	1,112,305	2,136,961	1,029,249	1,107,711	33,545
1901 . . .	1,415	1,154,770	2,143,326	1,098,587	1,044,739	29,789
1902 . . .	1,280	1,226,259	2,158,610	1,189,153	969,457	27,542
1903 . . .	[illegible]	1,286,718	2,303,164	1,277,453	925,011	25,541

TABLE IV (*Continued*)

(*C*) Analysis of the Principal of the Interest-bearing Debt from 1856 to 1904

(,000 omitted)

Year beginning July 1	2 per cents	3 per cents	3½ per cents	4 per cents	4½ per cents	5 per cents	6 per cents	7 3/10 per cents	Total Interest-bearing Debt
1856 . . .	—	—	—	—	—	$3,632	$28,130	—	$31,762
1857 . . .	—	—	—	—	—	3,498	24,971	—	28,460
1858 . . .	—	—	—	—	—	23,538	21,162	—	44,700
1859 . . .	—	—	—	—	—	37,127	21,162	—	58,290
1860 . . .	—	—	—	—	—	43,476	21,164	—	64,640
1861 . . .	—	—	—	—	—	33,022	57,358	—	90,380
1862 . . .	—	—	—	$57,926	—	30,483	154,313	$122,582	365,304
1863 . . .	—	—	—	105,629	—	30,483	431,444	139,974	707,531
1864 . . .	—	—	—	77,547	—	300,213	842,882	139,286	1,359,930
1865 . . .	—	—	—	90,496	—	245,709	1,213,495	671,610	1,221,311
1866 . . .	—	—	—	121,341	—	201,982	1,195,546	813,460	2,332,331
1867 . . .	—	—	—	17,737	—	198,533	1,543,452	488,344	2,248,067
1868 . . .	—	$64,000	—	801	—	221,586	1,878,303	37,397	2,202,088
1869 . . .	—	66,125	—	—	—	221,588	1,874,347	—	2,162,060
1870 . . .	—	59,550	—	—	—	221,588	1,765,317	—	2,046,455
1871 . . .	—	45,885	—	678	—	274,236	1,613,897	—	1,934,696
1872 . . .	—	24,665	—	678	—	414,567	1,374,883	—	1,814,794
1873 . . .	—	14,000	—	678	—	414,567	1,281,238	—	1,710,483
1874 . . .	—	14,000	—	678	—	510,628	1,213,624	—	1,738,930
1875 . . .	—	14,000	—	678	—	607,132	1,100,865	—	1,722,676
1876 . . .	—	14,000	—	—	—	711,685	984,999	—	1,710,685
1877 . . .	—	14,000	—	—	$140,000	703,266	854,621	—	1,711,888
1878 . . .	—	14,000	—	98,850	240,000	703,266	738,619	—	1,794,735
1879 . . .	—	14,000	—	741,522	250,000	508,440	283,681	—	1,797,643
1880 . . .	—	14,000	—	739,347	250,000	484,864	235,780	—	1,723,993

TABLE IV, *C* (*Continued*)

Year beginning July 1	2 per cents	3 per cents	3½ per cents	4 per cents	4½ per cents	5 per cents	6 per cents	7 3/10 per cents	Total Interest-bearing Debt
1881 . . .	—	$14,000	—	$739,347	$250,000	$439,841	$196,378	—	$1,639,567
1882 . . .	—	14,000	$460,461	739,349	250,000	—	—	—	1,463,810
1883 . . .	—	318,204	32,082	737,942	250,000	—	—	—	1,338,229
1884 . . .	—	238,612	—	737,951	250,000	—	—	—	1,226,563
1885 . . .	—	208,190	—	737,960	250,000	—	—	—	1,196,150
1886 . . .	—	158,046	—	737,967	250,000	—	—	—	1,146,014
1887 . . .	—	33,716	—	737,975	250,000	—	—	—	1,021,692
1888 . . .	—	14,000	—	714,315	222,207	—	—	—	950,522
1889 . . .	—	14,000	—	676,214	139,639	—	—	—	829,853
1890 . . .	—	14,000	—	602,297	109,015	—	—	—	725,313
1891 . . .	—	—	—	559,659	50,869	—	—	—	610,529
1892 . . .	—	—	—	559,664	25,364[1]	—	—	—	585,029
1893 . . .	—	—	—	559,672	25,364[1]	—	—	—	585,037
1894 . . .	—	—	—	559,677	25,364[1]	50,000	—	—	635,041
1895 . . .	—	—	—	500,837	25,364[1]	100,000	—	—	716,202
1896 . . .	—	—	—	721,999	25,364[1]	100,000	—	—	847,363
1897 . . .	—	—	—	722,000	25,364[1]	100,000	—	—	847,365
1898 . . .	—	—	—	722,002	25,364[1]	100,000	—	—	847,367
1899 . . .	—	198,678	—	722,005	25,364[1]	100,000	—	—	1,046,048
1900 . . .	$307,125	128,843	—	517,879	21,979[1]	47,651	—	—	1,023,478
1901 . . .	445,940	99,621	—	419,724	—	21,854	—	—	987,141
1902 . . .	445,940	97,515	—	368,203	—	19,410	—	—	931,070
1903 . . .	520,143	83,107	—	291,906	—	19,385	—	—	914,541
1904 . . .	542,909	77,135	—	175,112	—	—	—	—	895,157

[1] Continued at 2 per cent.

V

STATEMENT OF THE UNITED STATES TREASURY, NOVEMBER 1, 1905.
CASH IN THE TREASURY

IN DIVISIONS OF ISSUE AND REDEMPTION

Reserve Fund

Gold coin and bullion in Division of Redemption	$150,000,000

Trust Funds

Held for the Redemption of the Notes and Certificates for which they are respectively pledged.

Division of Redemption		Division of Issue	
Gold coin	$524,455,969	Gold certificates outstanding	$524,455,969
Silver dollars	476,308,000	Silver certificates outstanding	476,308,000
Silver dollars of 1890	8,621,000	Treasury notes outstanding	8,621,000
	$1,009,384,969		$1,009,384,969

General Fund

Gold coin and bullion			$78,585,548.93
Gold certificates			44,490,530.00
Standard silver dollars			1,477,554.00
Silver certificates			4,682,224.00
Silver bullion			2,560,992.57
United States notes			6,573,536.00
Treasury notes of 1890			26,622.00
National bank notes			12,194,985.00
Subsidiary silver coin			8,396,273.00
Fractional currency			150.72
Minor coin			534,560.20
			159,522,976.42
In National Bank Depositaries —			
To credit of the Treasurer of the United States		$56,221,926.21	
To credit of disbursing officers		9,504,386.17	
		65,726,312.38	
In Treasury of Philippine Islands —			
To credit of the Treasurer of the United States	$1,663,824.19		
To credit of United States disbursing officers	2,458,214.54	4,122,038.73	
Awaiting reimbursement —			
Bonds and interest paid		36,239.40	69,884,590.51
			229,407,566.93
Liabilities —			
National bank 5 per cent fund		19,404,902.75	
Outstanding checks and warrants		12,589,299.60	
Disbursing officers' balances		59,511,457.10	
Post-Office Department account		3,693,127.30	
Miscellaneous items		2,393,491.35	97,592,278.10
Available cash balance			$131,815,288.83

VI

RECEIPTS AND EXPENDITURES OF MASSACHUSETTS IN 1904

(*A*) Receipts

	1904
Corporation taxes, net	$1,182,668.15
Bank stock taxes, net	346,146.63
Savings bank taxes, including Massachusetts Hospital Life Insurance Company	1,714,698.55
Collateral legacy tax	562,193.40
Insurance taxes and licenses	511,765.17
Excise tax on life insurance companies	285,333.25
Excise tax on foreign corporations	48,810.16
Foreign railroad companies' tax	24,649.80
Coal and mining companies' tax	52.15
Secretary's fees	79,731.30
Fees from courts of probate, etc.	15,264.04
Fees from inspection of boilers	10,572.53
Sales of books	3,127.91
Income from sundry institutions	49,780.02
Liquor licenses	802,294.40
Support of paupers from cities and towns	2,580.57
Interest on revenue bank balances, net	42,585.22
Miscellaneous	339,028.04
Total revenue	$6,021,281.29
State tax	2,500,000.00
Cash on hand January 1	1,396,749.28
Totals	$9,918,030.57

(*B*) Expenditures

	1904
Legislative department	$358,725.21
Executive and other departments	198,505.70
State House	117,673.80
Printing other than legislative	85,128.22
Judiciary	435,007.80
Commissions and other boards	607,633.13
Agricultural, including Cattle Commissioners and expenses of the Gypsy Moth Commission	176,593.15
Educational, including State Library	802,147.30
Charitable	2,406,934.92
Military	365,954.30
State and military aid and other war expenses	863,260.26
Reformatory and correctional	968,986.89
Public buildings	90,022.05
Sinking funds and Massachusetts school fund	100,000.00
Interest on actual State debt	772,918.32
Miscellaneous	270,154.28
	$8,619,603.33

VII

SUMMARY STATEMENT OF RECEIPTS AND EXPENDITURES OF THE CITY OF BOSTON AND COUNTY OF SUFFOLK, FOR THE FISCAL YEAR 1903–1904

Grouped according to the "Uniform System" of the National Municipal League

Receipts: Total	Receipts: Trust Funds	Receipts: Extraordinary	Receipts: Ordinary		Expenditures: Ordinary	Expenditures: Extraordinary	Expenditures: Trust Funds	Expenditures: Total
				City of Boston				
$34,971.70	—	—	$34,971.70	I. General Government	$1,235,545.47	$69,130.04	—	$1,304,675.51
113,860.68	$8,432.58	—	105,428.10	II. Public Safety	3,660,543.24	86,151.76	$8,520.00	3,755,215.00
265,821.62	783.00	—	265,038.62	III. Public Charity and Correction	1,606,397.47	375,574.83	474.00	1,982,446.30
200,538.79	—	$87,096.16	113,442.63	IV. Public Works	3,911,794.43	4,806,641.58	—	8,718,436.01
3,645,494.13	—	177,579.80	3,467,914.33	V. Public Industries	3,194,740.70	1,070,829.62	—	4,265,570.32
109,358.80	29,423.82	15,698.72	64,236.26	VI. Public Education, Recreation and Art	4,727,150.11	1,972,819.15	16,752.68	6,716,721.94
20,307,333.74	—	134,419.30	20,172,914.44	VII. Taxation[1]	903,200.00	—	—	903,200.00
6,617,200.00	—	6,617,200.00	—	VIII. Public Debt	1,387,987.00	202,020.00	—	1,590,007.00
179,073.30	—	19,092.15	159,981.15	IX. Interest	2,215,517.36	547,344.52	—	2,762,861.88
2,002.16	—	—	2,002.16	X. Miscellaneous	—	—	—	—
$31,475,654.92	$38,639.40	$7,051,086.13	$24,385,929.39	Total for City of Boston	$22,842,875.78	$9,130,511.50	$25,746.68	$31,999,133.96
				County of Suffolk				
—	—	—	—	I. General Government	6,437.89	—	—	6,437.89
148,320.92	—	—	148,320.92	II. Public Safety	853,899.70	27,848.40	—	881,748.10
146,686.60	—	80,000.00	66,686.60	III. Public Charity and Correction	262,880.06	158,741.47	—	421,621.53
—	—	—	—	IV. Public Works	3,777.22	—	—	3,777.22
—	—	—	—	VIII. Public Debt	61,653.00	—	—	61,653.00
—	—	—	—	IX. Interest	125,130.00	—	—	125,130.00
192.00	—	—	192.00	X. Miscellaneous	—	—	—	—
$295,199.52	—	$80,000.00	$215,199.52	Total for County of Suffolk	$1,313,777.87	$186,589.87	—	$1,500,367.74
$31,770,854.44	$38,639.40	$7,131,086.13	$24,601,128.91	Grand Total City and County	$24,156,653.65	$9,317,101.37	$25,746.68	$33,499,501.70
110,252.00	110,252.00	—	—	Bookkeeping Items, Trust Funds	—	—	108,000.00	108,000.00
10,365,343.51	—	—	—	Bookkeeping Items, Other	—	—	—	10,353,639.61
$42,246,449.95	—	—	—	Total Receipts and Expenditures	—	—	—	$43,961,141.31

[1] Includes taxes levied to meet county expenditures which cannot be separated. The county tax warrant for 1903 was $1,187,468.

VIII

RECEIPTS AND EXPENDITURES OF GREAT BRITAIN AND IRELAND IN 1904

(*A*) Receipts (in thousands of pounds)

1. Customs —		
Exports: coal	2,052	
Imports:		
Tobacco	12,627	
Tea	6,559	
Spirits	4,458	
Wine	1,336	
Sugar	5,726	
Coffee	188	
Raisins and currants	337	
Miscellaneous	638	
		33,921
2. Excise —		
Spirits	17,815	
Beer	13,027	
License duties	253	
Railways	359	
Miscellaneous	92	
		31,546
3. Stamp duties —		
Deeds	3,303	
Receipts	1,560	
Bills of exchange	690	
Corporation capital	475	
Patent medicines	323	
Miscellaneous	1,043	
		7,394
4. Inheritance taxes —		
Estate duty	9,274	
Legacy duty	2,967	
Succession duty	698	
Miscellaneous	96	
		13,034
5. Land tax		743
6. House tax		1,896
7. Income tax		30,500
8. Public industries —		
Post-office	15,559	
Telegraph	3,674	
Crown lands	489	
		19,722
9. Interest on Suez Canal shares		982
10. Miscellaneous		1,604
Total		141,345

(*B*) Expenditures (in thousands of pounds)

1. Permanent appropriations —		
National debt	27,000	
Civil list	470	
Judicial expenses	521	
Miscellaneous	633	
Payments to account of local taxation	1,157	29,781
2. Annual appropriations —		
Army	36,677	
Navy	35,476	
Civil service	26,870	
Collection of taxes	3,085	
Post office	9,758	
Telegraph	4,528	
Packet service	786	117,180
3. Total		146,961

IX

LOCAL RECEIPTS AND EXPENDITURES OF ENGLAND AND WALES IN 1888–89 AND 1902–03

A. Receipts (in thousands of pounds)

	1888-89	1902-03
1. Contributions from the national government	4,791	12,783
2. Local rates	27,420	50,328
3. Tolls, dues, and duties	3,718	4,127
4. Rents, interest, etc.	1,400	2,412
5. Fees, fines, penalties, licenses	1,171	988
6. Waterworks	2,400	4,185
7. Gas works	3,678	7,169
8. Electric lighting works	—	1,881
9. Tramways	126	3,798
10. Miscellaneous	3,272	6,264
Total ordinary revenue	47,976	93,935
11. Revenue from loans	7,000	35,271
Total revenue	54,976	129,206

B. Expenditures (in thousands of pounds)

1. By unions and parishes in relief of poor	8,366	13,610
2. Other parochial expenditure	1,510	4,092
3. By burial boards and similar bodies	523	667
4. By school boards	5,339	13,488
5. By town and municipal authorities for police, sanitation, and public works	29,003	79,995
6. By rural district councils	604	1,800
7. By county authorities for police, lunatic asylums, etc.	3,066	7,736
8. Roads and bridges	2,177	2,185
9. By drainage and embankment authorities	458	435
10. By harbor authorities	2,977	4,819
11. Miscellaneous	54	142
Total expenditures	54,077	128,969

X

RECEIPTS AND EXPENDITURES OF FRANCE IN 1904

A. Receipts (in thousands of francs)

1. Taxes—		
Direct taxes	497,229	
Taxes assimilated to direct taxes	49,198	
Registration duties	569,149	
Stamp duties	182,148	
Tax on securities	79,781	
Tax on stock exchange operations	7,088	
Customs	405,940	
Excise taxes, etc.	594,764	
Tax on sugar	137,168	2,522,465
2. Monopolies and Industries—		
Tobacco monopoly	432,974	
Match and gunpowder monopolies	46,720	
Post and telegraphs	293,349	
Mint, railways, and miscellaneous	19,856	
Domains and forests	68,650	861,549
3. Miscellaneous		181,377
Total		3,565,391

B. Expenditures (in thousands of francs)

1. President, Senate, and Chamber of Deputies	13,507	
Finance ministry	19,604	
Justice	36,480	
Foreign affairs	16,859	
Interior	80,776	
Public worship	42,385	
War	676,330	
Navy	312,829	
Public Instruction	223,908	
Fine Arts	14,028	
Commerce and industry	49,414	
Agriculture	43,986	
Public works	229,194	
Colonies	108,293	1,867,593
2. Public debt		1,215,368
3. Collection of taxes	213,987	
Repayments, etc.	33,098	
Post and telegraph	235,175	482,260
Total expenditures		3,565,221

XI

RECEIPTS AND EXPENDITURES OF THE GERMAN EMPIRE IN 1902

(*A*) RECEIPTS (in thousands of marks)

1. Customs[1]		497,589
2. Excise duties —		
Tobacco	12,027	
Sugar	98,166	
Salt	49,357	
Spirits	128,103	
Beer	29,116	
Other	2,750	
		319,519
3. Customs and excise duties in territory outside of customs frontier		75
4. Stamp duties		91,776
5. Industries —		
Post and telegraph	437,027	
Railroads	90,109	
Printing office	8,498	
		535,634
6. "Invalidenfond"		48,385
7. Bank		9,337
8. Payments from states exempt from certain taxes		15,787
9. Contributions from the German states		580,640
10. Miscellaneous administrative revenues		38,053
Total ordinary receipts		2,136,795
11. Loans and other extraordinary revenue		40,077
Total receipts		2,176,872

(*B*) EXPENDITURES (in thousands of marks)

I. RECURRING EXPENDITURES

1. Reichstag and chancellor	1,097
2. Foreign affairs	14,669
3. Interior	59,690
4. Army	574,477
5. Navy	88,706
6. Justice	2,176
Carried forward	740,815

[1] The most important contributors to the customs revenue were as follows (in millions of marks): corn, malt, pulse, etc., 159; petroleum, 71.4; coffee, 68.8; tobacco, 55.2; wood and lumber, 16.4; wines, 16.4. — ED.

Brought forward		740,815
7. Finance —		
Treasury	682	
Revenues assigned to the several states	556,235	
Other objects	14,854	
Court of accounts	941	572,712
8. Pensions, etc.		121,761
9. Industries —		
Post and telegraph	382,417	
Railroads	67,029	
Printing office	5,743	455,189
10. Imperial debt		96,039
Total recurring expenses		1,986,516

II. Non-recurring Expenditures

(*a*) Ordinary —		
11. Foreign office and colonial administration		20,602
12. Interior		3,245
13. Army		59,750
14. Navy		75,392
15. Treasury		23
16. Industries —		
Post and telegraph	12,143	
Printing office	706	
Railroads	4,541	17,390
Total		176,402
(*b*) Extraordinary —		
17. Interior		3,074
18. Army		35,477
19. Navy		53,302
20. Asiatic expedition		39,539
21. Industries —		
Post and telegraph	15,892	
Railroads	10,369	26,261
Total		157,653

III. Summary

22. Recurring expenditures		1,986,516
23. Non-recurring —		
Ordinary	176,402	
Extraordinary	157,653	334,055
Total		2,320,571

ANNOUNCEMENTS

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